THE STERLING ASSETS
OF
THE RESERVE BANK OF INDIA

BY

B. R. SHENOY
Principal and Professor of Economics
S.L.D. Arts College, Ahmedabad

NEW DELHI
INDIAN COUNCIL OF WORLD AFFAIRS

BOMBAY CALCUTTA MADRAS LONDON
OXFORD UNIVERSITY PRESS

First published March 1946

PREFACE

This book is the result of an attempt to examine in some detail the arguments originally advanced, in brief, in a paper written for the Pacific Relations Conference, San Fransisco. The more elaborate investigation has rendered the thesis clearer; it has, besides, enabled deliberation on issues which, in the limited space of a paper, either could not be considered at all or could be only alluded to in passing.

Chapter I comprises the story, narrated with the aid of Reserve Bank statistics and statistics published by the Government of India, of how sterling came to be accumulated with the Reserve Bank; it explains, too, that the rupees created against the sterling assets were entirely inflationary in character.

Chapters II and III examine the effects on the Indian economy of the sterling accumulations, Chapter II dealing with the distortions produced in the pre-war pattern of the distribution of income and wealth, and Chapter III dealing with the effect of the sterling assets upon the debtor-creditor status of the country. Contrary to, what would now seem to be, the general belief, I have maintained that, notwithstanding the sterling assets, India continues to be a debtor country, on income as well as on capital account.

If she is a creditor, it can be only in the sphere of short-term capital; which, possibly, except for brief intervals, she has always been. In fact, debtor countries must necessarily be short-term creditors in the sense that they must build up short-term credits abroad through surplus exports in order to be able to meet debt services as they fall due. And, if the magnitude of the short-term credits is larger to-day than before, since these were acquired only through inflation, but not through the voluntarily generated (or authoritarian, non-monetary) savings, the money value of the foreign capital in India may also be said to have risen in a similar ratio; so that, even as before, the short-term creditor position would be insufficient to cancel the long-term indebtedness of the country, although, to quote Lord Keynes' rather discreet phrase, the debtor-creditor position, undoubtedly, has been "shifted" somewhat. The volume of the net indebtedness

may be less than before, but debtor the country remains nevertheless.

Chapter IV is a study of the several possible alternative methods of financing the United Nations' rupee expenditure; it gives an estimate of the extent to which the several sources were actually tapped. Chapter V outlines the manner of how the United Nations' rupee expenditure might have been financed without recourse to inflation.

And Chapter VI, after examining the various theoretical possibilities, indicates the more probable methods of how the sterling assets are likely to be redeemed. It also formulates, in outline, a policy which we may pursue with profit; the implementation of this policy, however, requires full political sovereignty. If what we have said in this chapter regarding the ratio of the sterling assets to the British national output is broadly correct, given willingness on the part of the debtor to make the necessary sacrifice, there should be little difficulty in paying off the sterling assets in the manner, and at the pace, determined by the requirements of India (and of the other creditors). If, however, in comments on the subject in the British press and also by spokesmen of British interests in our own country, the difficulties of redemption have loomed so large it is principally because our political helplessness (and also that of most of the other creditors) renders access to less irksome ways of escape comparatively easy.

In view of my present connexion with the Reserve Bank of India it is, I think, necessary to state that this book was completed, and was in the press, before I joined the Bank. The responsibility for the views expressed, and for the statements made, therein is entirely my own.

B. R. S.

CONTENTS

LIST OF TABLES

CHAPTER I

ACCUMULATION OF THE STERLING ASSETS

I. The Amount of the Sterling Assets

The aggregate sterling resources of India fall naturally under three heads: (1) sterling balances and securities held by the Reserve Bank; (2) sterling investments and balances of commercial banks and (3) sterling investments, other than those covered by (2), held on private account, i.e., by companies, firms or individuals. Of these three categories no statistics are available of the latter two. But the magnitude of the third would be, doubtless, negligible and that of the second, though vastly more than the third, would, nevertheless, be small when compared to the magnitude of the first. In what follows we shall occupy ourselves solely with the sterling assets of the Reserve Bank of India.

These assets are principally in the form of 'Sterling Securities', with a maturity of not more than five years, held in the Issue Department as part of the cover against the note circulation, and partly in the form of cash and short-term securities appearing under the head 'Balances held Abroad' on the assets side of the Banking Department. Technically the latter may comprise sterling as well as non-sterling currencies and an enquiry whether, in fact, they contained any quantities of the latter produced from the Reserve Bank the most illuminating answer that they 'include all foreign balances which the Bank may hold to its credit in the Banking Department'.[1] However, that the entire amount of the balances was only sterling becomes clear from a comparison of the statistics published by the Bank and the amounts of the war-time increases in the 'Sterling holdings of the Reserve Bank' as given in the Explanatory Memorandum

1. But I must at once add with grateful thanks that the Bank has been good enough to reply to several of my queries to my complete satisfaction.

accompanying the Government of India budget. The relevant figures are as under :—

TABLE I

Sterling Assets of the Reserve Bank as given by the Bank and the Budget
(*Crores of Rupees*)

		A	B	C	D
		In the Issue Department[3]	In the Banking[3] Department	TOTAL (A + B)	Figures given in the Budget
August 1939[2]	..	59·50	4·44	63·94	64
30 January 1942	..	248·62	54·77	303·49	307
29 January 1943	..	355·83	85·18	441·01	441
28 January 1944	..	744·83	132·98	877·81	878
26 January 1945	..	929·32	374·61	1,303·93	1,304

It will be noted that, except in respect of the amounts appearing against 30 January 1942, the figures in columns C and D are identical, the sums given in the budget being apparently corrected to a crore. It follows that the full amount of the figures under 'Balances held Abroad' in the Banking Department comprised sterling. Since the amount in column D in the exceptional case is *more*, not *less*, than the corresponding amount in column C, the same is also, doubtless, true of 30 January 1942. Presumably, the Bank held on this date about Rs. 3 crores worth of sterling under the head 'Investments' on the assets side of the Banking Department, which figure has been, quite naturally, included in column D but not in column B. On the assumption that the foreign balances

2. Average of Friday figures.
3. As given by the Reserve Bank.

in the Banking Department[4] are all sterling, the total sterling assets of the Reserve Bank are as under :—

TABLE II

Total Sterling Assets of the Reserve Bank
(Crores of Rupees)

Average of Friday Figures		A Sterling Securities in the Issue Department	B Balances held Abroad in the Banking Department	C Total Sterling Assets (A + B)
1938-39	..	66·95	4·21	71·16
August 1939	..	59·50	3·80	63·30
1939-40	..	78·63	12·34	90·97
1940-41	..	129·92	39·32	169·24
1941-42	..	165·00	46·08	211·08
1942-43	..	319·11	75·11	394·22
1943-44	..	643·52	111·72	755·24
1944-45	..	863·73	277·28	1,141·01
FRIDAY				
30 March 1945	..	978·32	385·06	1,363·38
24 August 1945	..	1,034·33	461·50	1,495·83

From about Rs. 71·16 crores, the weekly average for the year immediately preceding the war, the volume of the sterling assets in the possession of the Bank soon began to move up at an average rate of over one crore per week. The pace of their accumulation rapidly accelerated from the second half of 1941 onwards. On occasions they poured in at a daily

4. Before the war the quantity of sterling in the Banking Department was comparatively negligible. Since the commencement of the war, however, it began steadily to increase though at a pace fractional to the rate of increase in the Issue Department. But after the middle of 1944 the order of the relative expansion of their amounts in the two departments got reversed, partly as a result the accelerated growth in the volume of the 'Balances held Abroad' but mainly owing to a material slowing down in the rate of increase in the sterling securities held in the Issue Department.

rate of over a crore and latterly at nearly two crores per day. On 24 August 1945 their amount reached the huge figure of Rs. 1,495·83 crores or an increase of Rs. 1,432·53 crores over the amount for August 1939, the month preceding the declaration of war.

The problem of the sterling assets may be examined under four heads: (1) how did the Reserve Bank come to accumulate them and at so rapid a pace ?; (2) what have been their effects upon the Indian economy ?; (3) was a policy of sterling accumulations inevitable ?; and (4) what are the prospects which they hold out for the future ? The first question we shall attempt to answer in the present chapter and the remaining three, along with the issues arising out of them, in the five chapters following.

II. The Two Sources of Their Supply

The question of how the sterling assets came to be accumulated is easily answered. With the progress of war the expenditure in India of the Imperial Government increased at a terrific pace. To begin with, the magnitude of the expenditure being small, it could be set against—as was, in fact done—the amount of the Home Charges, the moneys annually owed by the Government of India to the United Kingdom. But when the amount of the Indian expenditure began to exceed the amount of the Home Charges, the former could be no longer wholly covered by being debited to the latter. Though the volume of the Home Charges did steadily move up it could gather none of the phenomenal momentum which characterized the growth of the Indian expenditure of the Imperial Government. In 1940-41, the second year of the war itself, the latter shot above the former and, as may be seen from the table below, the amount of the Home Charges very soon proved to be but a flea-bite when compared to the volume of the rupee requirements of the Imperial Government. The latter was thus confronted with the problem of finding rupees to meet its Indian bills, the amount of which was jumping up higher and higher each year at some geometrical progression. The Government of India's remittance demand for sterling, in other words, had ceased and in

TABLE III

British Expenditure in India and Home Charges
(Crores of Rupees)

	A	B	C
	War Expenditure Recoverable from the British Government	Home Charges	A—B
1939-40 ..	4·005[5]	27·07	— 23·07
1940-41 ..	53·33	30·48	+ 22·85
1941-42 ..	193·33	33·28	+160·05
1942-43 ..	337·33	48·97	+288·36

its place there had appeared, on an incomparably larger scale, a demand for rupees on the part of the British Government.

There was also the question of making payments for the surplus exports of the country, which, owing to a policy of curtailing the volume of imports, had materially grown in size. Though the actual dimensions of the surplus are not known, in the restricted field of trade in merchandise on private account, it was steadily moving upwards; as may be seen from Table IV (p. 15) below it rose from Rs. 41·87 crores in 1939-40 to the peak figure of Rs. 90·94 crores in 1943-44 before it declined again in 1944-45. Payment, in the final analysis, for the surplus,—whether, in the first instance, it yielded dollars or other foreign exchange, whether it represented the British Government's or the British public's purchases of war materials or goods or whether it was gold,—had necessarily to be found by the British Treasury. And, though the bills against it may be presented through the normal channels of exchange banking, instead of by the Government of India, in essence, the questions they gave rise to were on a par with those which related to war expenditure payable

5. *The Economist*, 26 September 1942, p. 393; the rest of the figures in the column are from *The Economist*, 3 June 1944, p. 754.

through the Government of India. Like the latter here, too, was a case of finding sufficient rupees for disbursal in India among those who made the goods or gold available for export. It was but a question of detail whether the disbursal had to be made by the Government of India or by a commercial body engaged in the business of exports.

III. The Mechanism of Their Accumulation

The problem, however, was far from a serious one. The sterling exchange standard had, long ago, provided for its solution. The Reserve Bank, even as was its predecessor the Finance Department of the Government, is obliged by law to issue rupees in India unlimitedly, in exchange for sterling deposited to its credit at the Bank of England, at the rate of 18 $\frac{3}{16}$ d. per rupee. It has no option or discretion in the matter, and, among the sterling documents which it can accept in this manner, British Government securities naturally occupied the highest rank.

This rendered a solution of the Imperial Government's problem an exceedingly simple affair. All that the British Treasury had to do was to keep in readiness the requisite quantities of the sterling securities and, as necessity arose, lodge the right assortment of them with the Bank of England to the credit of the Reserve Bank. On receipt of advice that this had been done the latter would release to the nominees of the Imperial Treasury equivalent currency in India and the time taken for doing so need not exceed that involved in cabling the advice. It was merely a matter of detail whether the securities were first credited to the account of the Reserve Bank or to that of the Government of India and whether the latter, acting as the agents of the British Government, asked for the issue of currency against them, or whether the problem of how best to find the equivalent rupees was left, as Sir Jeremy Raisman, the late Finance Member, tells us it was,[6] to the discretion of the Reserve Bank. The Bank of England, the Government of India and the Reserve Bank may,

6. Budget speech for 1943-44.

indeed, come to any mutual understanding, convenient to them, on the subject, without in any way prejudicing the principal fact, namely, that rupees were being raised through printing sterling securities. The same thing can also be done, as we shall presently indicate in some detail, by passing on the securities to the Reserve Bank through less obvious and more sophisticated devices. They may come into the possession of the Bank in the same manner as sterling representing the surplus exports of the country, that is, through the normal channels of the international financial machinery.

It did not, therefore, matter at all what the amount needed in India was nor the pace at which it was needed. So long as the printing presses in London and Nasik, the one to produce securities and the other to produce notes, remained in working condition, the Imperial Government need be in no difficulties whatever to meet its Indian bills or to appropriate the surplus exports of the country. If the harmful consequences of inflation were not deemed a serious affair in face of the exigencies of war, and whilst there was still room for currency expansion, in the sense that the point at which a 'flight from currency' began had not yet been reached and the danger of currency collapse was not yet in sight, this method of war finance could be pursued with perfect abandon. And an examination of the statistics published by the Reserve Bank would seem to provide conclusive evidence, as we shall presently indicate, that this device has been, in fact, freely employed by the British Government to cover its Indian expenditure.

IV. Was the Sterling Link the Cause of Inflation?

But it is important to note that the rupee-sterling link was no more than an instrument for implementing the Imperial will. It must not be mistaken for the root cause of the inflationary finance of British expenditure in India, as has sometimes been incorrectly imagined. One writer, for instance, has described the link as 'the villain of the piece as far as the issue of more Indian currency is concerned',[7]

7. V. K. R. V. Rao, *War and Indian Economy*, 1943, p. 114

and has fancied that but for it the British Government would have resorted to non-inflationary alternatives similar to those adopted in respect of their expenditure in America, namely, sale of British investments in India, issue of rupee loans, sale of merchandise and gold and might have limited their commitments to the rupee finance thus made available.[8] Indeed, so deeply convinced is he of the validity of the discovery he has made that, he has gone to the length of saying that if the rupee had not been linked to sterling India might have even got **swaraj** as Whitehall would have, then, been forced to instal a national government in New Delhi![9] We are told that, in view of the link, they were not 'equally interested'![10]

One might as well argue that the cause of the present war or of its continuance was the Bank of England as, in the absence of it, the British Government would be without a suitable machinery to help it fill the gap between Revenue and Expenditure through Ways and Means Advances, the issue of treasury bills and of Defence Loans of various kinds. And, as the sinews of war to be raised in this manner constituted approximately half[11] the national expenditure, all fighting would, then, have to cease or so might the argument go. But, of course, an Imperial power wanting to declare war would create a Bank of England if one had not been there already. Even so the machinery of the exchange standard would have been brought into existence, in order to enable Great Britain to inflate Indian currency for making purchases of Indian materials with, if the Reserve Bank of India Act had not provided for it in 1934. Germany had taken recourse to this device in all her conquered territories: the establish-

8. Ibid, p. 154.

9. Says Professor Rao: 'I can't help feeling that the Government at Whitehall would have realized the need for a national government in India and worked for it, (against themselves?), if they had been directly responsible for finding rupee finance and if the rupee had not been linked to sterling'. Ibid, p. 155.

10. Ibid, p. 155.

11. In 1944 out of a total expenditure of £5,914 million, as much as £2,794 million or 47·3 per cent was raised by public borrowing. See *The Economist*, 5 May 1945, p. 596.

ment of a link of the local currencies to the mark was, in fact, one of the first acts of the provisional governments established in the wake of the conquering armies. The link was certainly not the cause of the inflation imposed by Germany upon the vanquished countries. It was only an instrument, a conduit pipe, for pouring inflationary money into them.

Furthermore, it was not as if the only remaining alternatives, to the convenient device presented by the exchange standard for inflationary finance, were the non-inflationary methods of the kind pursued by Great Britain in America. There exist besides several other ways,[12] whereby to acquire goods from political dependencies against paper. Given a Governor-General and a Council in New Delhi responsible to the British Government, even assuming an independent rupee currency, Imperial expenditure in India could still be met by the expansionary issue of rupees against Indian treasury bills or from out of Ways and Means Advances raised from the Reserve Bank. Alternatively notes of the Bank of England, or a new pattern of notes issued by a specially created body, may be put into circulation. It was certainly not necessary that the snapping of the link should automatically lead to a liquidation of the British Empire in India or to the appointment of a national government for presiding over it. In other words, removal of the link would not remove with it the cause of inflation. For the cause we must look elsewhere than in the technical mechanism of linking one currency to another.

V. Theoretical Classification of the Sterling Assets

Theoretically, sterling which may at any time be in the possession of the Reserve Bank may be classified under one or the other of two heads. It may represent, in the first place, the proceeds of the overall surplus exports of the country, that is, the surplus merchandise exports less the payments due on the surplus invisible imports including Home Charges

12. For the methods employed by Germany see *The Economist*, 24 August 1940, p. 249.

plus the net exports of gold or minus the net imports of gold into the country. The Reserve Bank would be, so to speak, the natural heirs to India's claims, equivalent to the balances remaining after this arithmetic, upon the outside world. For, the emergence of a positive magnitude from out of the arithmetic would imply that the demand of the country for foreign exchange on account of imports of all kinds has been met in full. The final balance left behind would merely represent the surplus available supplies of foreign exchange over and above this demand. Its owners, therefore, would be unable to convert it into Indian money through sale in the foreign exchange market. If they needed rupees they would have no alternative but to offer it to the Indian currency authority. And, as the Reserve Bank is not obliged to accept foreign exchange other than sterling, the residual balance, if not already in the form of sterling, would first have to be converted into sterling, through the foreign exchange markets abroad, before the Reserve Bank may be asked to provide Indian currency against it.

It is clear, therefore, that the final balance remaining from the surplus exports of the country (merchandise plus gold) would get itself transformed into sterling and find a resting place in the vaults of the Bank of England to the credit of the Reserve Bank. That is to say, the overall surplus exports of the country may provide one explanation of the net sterling accumulations with the Reserve Bank. It is, of course, immaterial whether the surplus exports of merchandise or gold were bought by private individuals abroad or, as in the case we are considering, also by the Government of the importing country. In either case the Reserve Bank would receive equivalent sterling.

If the amount of sterling accruing to the Bank should exceed the amount accountable under the first head, the excess sterling so accruing would represent Imperial or allied war expenditure in India. There is nothing else from which it may issue forth. And, so long as the sterling exchange standard remained in operation and it was not mandatory upon the Reserve Bank to purchase any currency other than sterling, and the Bank did not ordinarily do so, it was a matter of indifference whether the aggregate of the allied

and Imperial expenditure was payable by the Imperial Treasury on behalf of the British and other Governments, as was, in fact, the case, or whether the allied Governments made their own independent arrangements, offered by the normal channels of international banking, for meeting their Indian expenditure. In either of these cases there would accumulate with the Reserve Bank *ad hoc* sterling created by the British Treasury.

That this would be so in respect of the British expenditure in India is clear enough. It is a mere matter of machinery whether payments were first made in credits at the Bank of England and the credits so received were converted into treasury bills or whether the bills themselves were right away lodged with the Bank of England to the credit of the Reserve Bank. The Reserve Bank, on its part, would prefer interest-earning documents to mere book credits and even if paid in terms of the latter it should seek an early opportunity to convert them, beyond the limit of its day to day cash requirements, into bills. Probably it has issued standing orders to the Bank of England to convert sterling accumulations in excess of a certain minimum into treasury bills or such other interest-bearing securities which the Reserve Bank Act permits it to hold. And the British Treasury, we should imagine, would also prefer to meet its Indian obligations in treasury bills rather than by raising Ways and Means Advances from the Bank of England, as the cost of the latter would be more than the cost of the former. Moreover, for psychological reasons,[13] it may wish to keep such borrowing from growing indefinitely. Both parties, therefore, would readily welcome opportunities to replace cash payments by

13. So long as the amount borrowed from the Bank of England remained to the credit of the Reserve Bank its effect upon the British economy need be no more inflationary than the sterling treasury bills held by the latter. But in view of the inflationary consequences of Ways and Means Advances, when these latter get transferred to parties in Great Britain, the natural inclination would be to put a break upon such borrowing, whenever it may tend to grow beyond limits. See R. S. Sayers, *Modern Banking*, London, 1938, p. 273.

treasury bills. In actual practice the affairs of the British Treasury, including the issue of treasury bills and other Government securities, as well as those of the Reserve Bank, being both managed by the Bank of England the implementation of the preferences of the two gets reduced to a simple process of book entries and sterling treasury bills may be expected to pile up to the credit of the Reserve Bank almost simultaneously with the progress of Imperial expenditure in India.

The same would also hold true of the U.S. and other allied expenditure. The manner of how it would happen is somewhat as follows. The demand of the U.S. Treasury for rupees would bid up the price of the latter in terms of dollars to the point at which, at the prevailing dollar-sterling exchange rate, it would become worth-while first to acquire sterling, either against dollars or by shipping gold to London, and obtain rupees from the Reserve Bank in return for sterling thus acquired. Since the rupee is on the sterling exchange standard and the Reserve Bank is not obliged to issue rupees except against sterling, the U. S. Treasury would be unable to demand Indian Currency by offering dollars or gold[13a] to the Reserve Bank directly. It would perforce have to look to London, not Bombay, for a solution of its rupee exchange problems. And, as under Defence Regulations, all foreign exchanges and gold accruing in London would be taken over by the British Treasury, it becomes at once clear that it would be the Bank of England which, acting as agents to the Treasury, would arrange to meet the U.S. demand for rupees by offering sterling treasury bills to the Reserve Bank equivalent to the dollars or gold received by the British Exchange Control. In other words sterling will come to be accumulated with the Reserve Bank against U.S. and allied expenditure in India.

But, rather than settle down to a solution of this problem in this circuitous manner, through the normal machinery of exchange banking, both Treasuries would, probably, find it to

13a. There is no possibility of gold being offered because its statutory price is but a fraction of the market price.

their mutual advantage to arrive at some agreed procedure[14] whereby dollars are exchanged for sterling treasury bills and the latter for rupees more directly. To the U.S. Treasury such an arrangement would be not only less troublesome and a saving of time but also less expensive as, by avoiding a scramble for rupee exchange, which must ensue upon the U. S. Treasury bidding for it in the open market, it would be able to obtain rupees at a more advantageous rate. It would suit the requirements of the British Treasury as well because it would enable the latter to pay for the dollars in treasury bills directly instead of having to do so, at first, from the proceeds of Ways and Means Advances, which it may have to do when the dollars come into its possession through the exchange market. Moreover, it would help to prevent unnecessary shipping of gold between New York and London.

It is not necessary, however, that all the sterling paper in the possession of the Reserve Bank should be presented to it by the British Treasury directly. Some may, without any prejudice whatever to the central principle, just as well come into its hands indirectly through the intermediary of the banking system. The exchange banks in India, for instance, may discount or otherwise acquire bills drawn on a British Government department representing British official purchases of Indian exports,[15] or the British or allied expenditure in India. They may also take over the bills drawn on a British Government trading firm such as the U.K.C.C. against goods supplied to Russia or to the Middle Eastern countries. Though payment for the goods would be received in the currencies of the countries concerned the bills against the exports will be drawn on London and will be payable in sterling. They would, then, be presented to the bankers of the British Treasury, the Bank of England, for encashment and sterling thus received may be offered to the

14. An agreement, in fact, exists between the British and American Governments on the subject, whereby dollars are paid to the British Treasury in return for rupees provided in India against sterling passed on to the Reserve Bank. See Budget speech for 1942-43, p. 12.

15. The Ministry of Supply, the Ministry of Food, the Anglo-American Purchasing Commission and the United Buying Organization, for instance, make direct purchases of their requirements from India.

Reserve Bank at its weekly tenders in return for rupees with which to purchase more bills of the same kind. The Reserve Bank may thereupon direct the Bank of England to acquire treasury bills with the sterling thus come into its possession. The same may also happen in respect of Indian exports sold to the British public.

It is clear, therefore, that the entire amount of the sterling assets in the possession of the Reserve Bank, whether they belong to the first or to the second head of our classification, forms part of the Indian contribution to the Imperial war effort. Sterling belonging to the first category tells the tale of the surplus exports of the country or their proceeds having been placed at the disposal of the British Government, while sterling falling under the second category is evidence of the goods and services passed on to it for use in India.

Sterling presented to the Reserve Bank need not necessarily result in an equivalent expansion of currency or credit in India, though, this is an obvious method of how rupees can be provided to the holders of sterling; it is quite possible to convert sterling into rupees without adding to the Indian monetary circulation. The Bank may, for instance, reduce its holdings of rupee securities by releasing them in the market or by allowing rupee treasury bills to mature into cash without being replaced by fresh treasury bills and provide in this manner the rupees demanded against sterling. In this case the monetary circulation will remain unchanged; only rupee securities in the possession of the Bank will fall by an amount compensatory to the rise in the volume of the sterling assets.

VI. The Ratio Between the Assets Representing Surplus Exports and War Expenditure

We shall now proceed to examine the figures of sterling accumulations with the Reserve Bank with a view to seeing how far the foregoing analysis applies in actual fact. In this task statistics of the balance of payments, the overall surplus exports of our definition, if available, would have been exceedingly helpful. But they have never been available in a form which would satisfy our requirements. Even the figures of 'visible balance of accounts', which covered but a limited range of the international balance sheet of the country, ceased to appear in the Reserve Bank's annual *Reports*

on Currency and Finance from 1938-39 onwards, in order, probably, to prevent the enemy from gaining useful information. We have also been deprived, may be for the same reason, of information regarding imports and exports of gold from 1939-40 and after. The Reserve Bank and the Government of India,[16] however, have provided full information about the purchases of sterling by the Bank in the open market since the outbreak of war, the amounts of sterling presented to it by the British Government and the manner of how the aggregate volume of it was disbursed. This would seem to make good the absence of data regarding the balance of payments. The relevant figures are as under:—

TABLE IV

Acquisition of Sterling and its Disposal by the Reserve Bank
(*Crores of Rupees*)

	A Sterling purchased by the Reserve Bank	B Sterling payments by His Majesty's Government	C Total Sterling Receipts (A + B)	D Sterling utilized for Repatriation and other commitments	E Sterling left behind with the Reserve Bank (C − D)	F Balance of Trade in Merchandise on private account
1939-40[17] ..	86	16	102	24	78	41·87
1940-41 ..	76	43	119	117	2	41·99
1941-42 ..	98	201	299	159	140	79·90
1942-43 ..	122	310	432	205	227	84·25
1943-44 ..	140	365	505	71	434	90·94
1944-45 ..	122	357	479	61	418	26·08
Total ..	644	1,292	1,936	637	1,299	365·03

In the above table we may presume that the figures in column A, sterling purchased by the Reserve Bank, represent the surplus exports (merchandise plus gold) of the country.

16. The latter in the *Explanatory Memorandum to the General Budget.*

17. From September 1939 to March 1940.

This presumption is supported by the fact that no part of it was demanded by the market back again.[18] Sterling was sold by the Bank only to the Government for purposes of repatriation or for meeting its other sterling commitments (column D). Apparently they are the balance remaining of the proceeds of exports after meeting all liabilities, on private account, of the visible as well as the invisible items of trade. If so these figures may be said to fall under the first head of our classification. Figures under column B are, clearly, payments in final settlement of the Imperial and allied war expenditure and would, consequently, belong to the second category of our classification.

At first sight it might seem somewhat strange that the amounts of the surplus exports as shown in column A should exceed the amounts of the merchandise balance of trade as given in column F of the table. Seeing that part of the merchandise balance would be always cancelled against the invisible liabilities of the country, the more reasonable expectation would be that the latter figures should be larger than the former. But the explanation would seem to be that the merchandise balance of war years is devoid of its normal significance. For it relates merely to transactions on private account. It does not include 'transactions on Government account for Defence purposes',[19] the magnitude of which, is, doubtless, considerable. If to the published figures are added the surplus ensuing from the latter group of transactions as well, the oddity attending a comparison of the figures in columns A and F may disappear. Further, column F does not include figures of the balance of trade in gold and silver bullion. In 1939-40, for instance, the last year for which statistics on the subject were published, the credits on account of surplus gold exports amounted to Rs. 44·64 crores. Similar additions would have to be made to the amount of the balance of trade for 1940-41 also. For, as the Bombay price of gold during the year had not yet departed from the parity price[20] converted into rupees at the official exchange rate, we may presume that gold continued to be exported too during

18. See *Report on Currency and Finance*, 1944-45, para 24, p. 39.
19. *Budget for 1943-44*, p. 115.
20. See p. 80 below.

1940-41.[21] Moreover, it is possible that, taxation of war profits and income in India being at lower rates than in the United Kingdom, the Indian earnings of residents in the latter country may have been reinvested in India on a larger scale than before the war, thereby leaving in the hands of the Reserve Bank a larger share of surplus exports in the shape of sterling than had been the case hitherto.

During 1939-40 and 1940-41, it will be noted from table IV, the amounts of sterling taken over by the Government of India for repatriation and other purposes (column D) exceeded the amounts paid into the Bank on account of recoverable war expenditure. We may, therefore, conclude that sterling, which remained behind with the Bank during these years, comprised only part of the proceeds of the surplus exports of the country. It contained no element of the second factor, that is, sterling representing British war expenditure in India. What was given of the latter by the one hand was, so to speak, taken away by the other.

During the following three years, however, the opposite was the case: official receipts of sterling during the years were in excess of sterling appropriated for redemption of debt and for liquidation of the other sterling commitments. Clearly, therefore, sterling which remained in the possession of the Reserve Bank at the end of these years was compounded of sterling of both classes of description. The entire amount of sterling of the first variety and part of the sterling of the second variety may be said to have been left unused.

This way of looking at the matter is only appropriate because employment of sterling in the possession of the Bank for repatriation and other official purposes amounts, in effect, as we have explained elsewhere,[22] to meeting the payments due to India on account of recoverable expenditure by cancelling the sterling debt and other sterling liabilities of the country. During 1941-42, for instance, His Majesty's Government paid into the Reserve Bank Rs. 201 crores of sterling and the Government of India utilized Rs. 159 crores of it to

21. That gold, on balance, was exported during 1940-41 is admitted in a chance remark made in the *Report on Currency and Finance, 1943-44*, p. 28 (last para.).

22. Chapter IV, pp. 85-86 below.

redeem its sterling obligations. In effect this comes to the same thing as saying that, in final settlement of the recoverable expenditure, the British Government paid to the Government of India Rs. 42 crores in *ad hoc* sterling and Rs. 159 crores in documents of the latter's own indebtedness to Great Britain. On this reasoning of Rs. 140 crores of sterling, which was added to the sterling portfolio of the Reserve Bank during the year, we may with justification say that Rs. 98 crores belonged to the first category of our classification (surplus exports) and the rest, Rs. 42 crores, to the second (war expenditure). In 1939-40, on the other hand, as the Government of India utilized Rs. 24 crores of sterling for repayment of debt while only Rs. 16 crores worth of the currency was received from the British Government, Rs. 8 crores were drawn upon from sterling receipts under the head of surplus exports after exhausting the full amount of the receipts under the second head, so that, the entire volume of sterling which remained with the Bank at the end of the year (Rs. 78 crores) belonged only to the former category. If this line of argument is correct, the two-fold classification of sterling in the possession of the Reserve Bank would be as follows :—

TABLE V

Classification of the Sterling Assets of the Reserve Bank
(*Crores of Rupees*)

	A	B	C	D	E
	Surplus Exports	War Expenditure	Total Sterling at the end of the year (A + B)	A as a percentage of C	B as a percentage of C
1939-40[23] ..	78	—	78	100·00	—
1940-41 ..	2	—	2	100·00	—
1941-42 ..	98	42	140	70·00	30·00
1942-43 ..	122	105	227	53·74	46·26
1943-44 ..	140	294	434	32·26	67·74
1944-45 ..	122	296	418	29·19	70·81
Total ..	562	737	1,299	43·26	56·74

23. September 1939 to March 1940.

It will be noted that the proportion of the sterling assets of the Bank representing surplus exports has been continually on the decline, from 100 per cent in 1939-40 and the following year to 29·19 per cent in 1944-45, while the portion of it representing British war expenditure in India during the same period has been correspondingly on the increase, from 0 to 70·81 per cent. Since, in the final analysis, both categories of sterling come to one and the same thing, namely, that they represent alike Indian contribution to Imperial war needs, the shifting of emphasis between them is, however, without any real significance. It merely indicates that the contribution made by providing goods and services for use of the British fighting services within the Indian frontiers has galloped faster than the contribution in the shape of surplus exports. The more material point is that the amounts of both have been on the increase.

VII. How Rupees Were Provided Against Sterling

There now remains to examine the manner of how the Reserve Bank provided rupee equivalents to sterling which was finally retained by it and tables VI, VII and VIII below would seem to give us strikingly precise information on the subject. The tables have been compiled from the *Annual Reports on Currency and Finance* and the monthly *Statistical Summary* published by the Reserve Bank. Table VI relates to the Issue Department, Table VII to the Banking Department and Table VIII, which brings together the results of Tables VI and VII, views the position with regard to the Bank as a whole. In constructing Table VII the amounts of 'Other Liabilities', which are made up of 'various amounts held in suspense, principally transactions in transit between the offices of the Bank and profits for distribution to shareholders and Government',[24] have been dropped and equal sums have been deducted from the assets side. As this item, which does no more than add to the magnitude on either side

24. J. B. Taylor, *Functions and working of the Reserve Bank of India*, 1941, p. 56.

TABLE VI

Progressive Increase[25] (+) or Decrease (—) in the Sterling and Rupee Securities, the Note Issue and the Coin Reserve in the Issue Department

(*Crores of Rupees*)

	A Sterling Securities	B Rupee Securities	C Total Securities	D Rupee Coins	E Note Issue	F Total Currency Issue (E — D)
1939–40 ..	+ 54·00 (+ 50·00)	+ 6·05 (+ 10·05)	+ 60·05 (+ 60·05)	—15·07 (—15·07)	+ 44·98 (+ 44·98)	+ 60·05 (+ 60·05)
1940–41 ..	— 11·26	+ 49·53	+ 38·27	—21·23	+ 17·04	+ 38·27
1941–42 ..	+110·61	+ 48·38	+158·99	— 7·18	+151·81	+158·99
1942–43 ..	+208·86	+ 38·21	+247·07	—13·02	+234·05	+247·07
1943–44 ..	+358·12	—116·14	+241·98	— 2·25	+239·73	+241·98
1944–45 ..	+198·49	— 0·49	+198·00	+ 1·82	+199·82	+198·00
Total ..	+918·82	+ 25·54	+944·36	—56·93	+887·43	+944·36

25. From last Friday of March.

of the balance sheet, is clearly unrelated to the phenomenon of credit creation or exchange transactions, its elimination would take away from the balance sheet nothing whatever of significance from the standpoint of our requirements. On the other hand there has resulted from this step material gain in clarity. For, as we shall presently see, it has helped to throw up the relevant elements in the situation in their right perspective.

From Table VI we see that, during 1939-40, the Issue Department received Rs. 60·05 crores worth of securities, of which Rs. 54 crores were sterling securities and the rest (Rs. 6·05 crores) rupee securities. In return the department issued equivalent currency, Rs. 44·98 crores in notes and Rs. 15·07 crores in coins. It follows that against sterling passed on to the Issue Department, during the year, the full amount of the rupees was provided by currency expansion. In respect of Rs. 14·06 crores worth of sterling, which was retained in the Banking Department, the position, however, seems at first sight to be slightly different. For Table VII indicates that the rupee equivalent of sterling presented to the department was found, Rs. 8·97 crores in deposits, Rs. 4·45 crores in notes and coin and the rest, Rs. 64 lakhs, by the sale of investments to the public.

But it would be a mistake to imagine that of the aggregate sum of Rs. 68·06 crores of sterling received by the Bank during the year a portion (Rs. 64 lakhs) was exchanged for rupees through the device of reducing its non-sterling assets, only the balance being met by monetary expansion. The correct situation is revealed by Table VIII, which views the affairs of the two departments together. It shows that the non-sterling assets of the Reserve Bank increased, instead of the opposite, although the increase was, naturally, lower by Rs. 64 lakhs than the figure of the increase in the Issue Department. It will be seen, too, that Reserve Bank money, made up of notes, coins and credit, was created to the full extent of the increase in the sterling as well as the non-sterling assets of the Bank (Rs. 73·47 crores). That is to say, the entire quantity of rupees provided in return for sterling presented to the Bank, during 1939-40, was found through monetary expansion; no part of it was raised through the

TABLE VII

Progressive increase[26] (+) or Decrease (—) in the Sterling Assets, Total Deposits, Notes and Coin, and Investments and other Assets in the Banking Department

(Crores of Rupees)

	A_1 Balances Sterling	B_1 Deposits Total	C_1 Notes and Coin	D_1 B_1—C_1	E_1 Investments and other Assets	F_1 D_1—E_1
1939-40 ..	+ 14·06 (+ 18·06)	+ 8·97 (+ 8·97)	— 4·45 (— 4·45)	+ 13·42 (+ 13·42)	— 0·64 (— 4·64)	+ 14·06 (+ 14·06)
1940-41 ..	+ 13·76	+ 23·17	— 2·06	+ 25·23	+ 11·47	+ 13·76
1941-42 ..	— 6·96	— 0·27	— 0·58	+ 0·31	+ 7·27	— 6·96
1942-43 ..	+ 52·05	+ 24·27	+ 0·57	+ 23·70	— 28·35	+ 52·05
1943-44 ..	+ 78·89	+ 79·16	+ 0·96	+ 78·20	— 0·69	+ 78·89
1944-45 ..	+218·83	+225·63	— 1·21	+226·84	+ 8·01	+218·83
Total ..	+370·63	+360·93	— 6·77	+367·70	— 2·93	+370·63

26. From last Friday of March.

sale of securities to the public. The mischievous illusion to the contrary was only a by-product of the separation of the two departments of the Bank.

That this is so may be easily seen. For, if the die of chance had chosen to cast differently and Rs. 50 crores of sterling alone, for instance, had been transferred to the Issue Department, the rupee securities in it had gone up by Rs. 4 crores, the investments in the Banking Department had fallen by an equal amount and the rest of the magnitudes in either department had remained unchanged, the various elements would have been as indicated in brackets under the actual figures for the year 1939-40 in Tables VI and VII above. An impression may, then, be created that as much as Rs. 4·64 crores of money was found by the non-inflationary method of the sale of securities, though the position, in the aggregate, as indicated by Table VIII, would be unaltered. In other words,

Table VIII

Progressive increase[27] in the Sterling Assets, Reserve Bank Money, and Investments and Other Assets of the Reserve Bank

(Crores of Rupees)

	α Sterling Assets $(A + A_1)$[28]	β Rupee Securities and other Rupee Assets $(B + E_1)$[28]	γ $\alpha + \beta$	δ Reserve Bank Money $(F + D_1)$[28]
1930-40 ..	+ 68·06	+ 5·41	+ 73·47	+ 73·47
1940-41 ..	+ 2·50	+ 61·00	+ 63·50	+ 63·50
1941-42 ..	+ 103·65	+ 55·65	+ 159·30	+ 159·30
1942-43 ..	+ 260·91	+ 9·86	+ 270·77	+ 270·77
1943-44 ..	+ 437·01	−116·83	+ 320·18	+ 320·18
1944-45 ..	+ 417·32	+ 7·52	+ 424·84	+ 424·84
Total ..	+1,289·45	+ 22·61	+1,312·06	+1,312·06

27. From last Friday of March.

28. The letters relate to columns in Tables VI and VII.

separation of the accounts of the two departments is easily capable of creating incorrect and illusory pictures of the real situation. What, in fact, had happened in 1939-40 was, probably, that Rs. 64 lakhs worth of non-sterling assets were transferred from the Banking to the. Issue Department, equivalent cash received in exchange from the latter by the former being passed on to the parties who had presented sterling to the Bank. While leaving unaffected the aggregate volume of assets with the Bank as a whole, this produced the result of lowering their magnitude in the Banking Department from which, as we saw, followed the incorrect impression reviewed above.

What we have said regarding 1939-40 applied also to 1942-43. During the year, though the non-sterling investments in the Banking Department declined by Rs. 28·35 crores, this was more than neutralized by a rise of Rs. 38·21 crores of rupee securities in the Issue Department so that, on balance, looking to the Bank as a whole, this class of assets increased by Rs. 9·86 crores. And as Reserve Bank money increased by the full amount of the increase in the sterling and the non-sterling assets of the Bank (Rs. 270·77 crores), sterling may be said to have been converted into rupees wholly through the method of monetary expansion. The same was the case during 1940-41, 1941-42 and 1944-45. No part of the rupees demanded during these years was provided by withdrawing moneys from circulation. Since, during these years, the rupee securities and other rupee investments in both departments moved upwards, instead of in opposite directions, this becomes clear when we view the balance sheets of the two departments separately as well as together. And, except for 1944-45, when payment in book credits (about Rs. 218·83 crores) exceeded somewhat payment in notes (Rs. 199·82 crores), the expansionary issue of money presented to the holders of sterling was mainly in the shape of the issue of paper currency and partly in the form of coins and deposits.

The year 1943-44 stands out apart from the rest of the war years. By now the Government had abandoned the plea,

which it had been advancing with force for some time,[29] that monetary expansion in India was not inflationary in character and had begun to admit openly that the issue of rupees against sterling for the finance of Imperial and allied expenditure had inflationary effects.[30] It had also started taking active measures such as increased taxation, sales of gold and campaigns for saving, to mop up the surplus purchasing power from the pockets of the public. The results of these measures necessarily had their effects upon the currency expansion of the year : for the first time in several years there was not only no inflation against rupee securities, but it became possible to meet a fair proportion of the demand for rupees on the part of the British and allied Governments from out of the funds collected by the anti-inflationary programme of the Government of India. The sterling assets of the Reserve Bank increased during the year by Rs. 437·07 crores (Rs. 78·89 in the Banking Department had Rs. 358·12 crores in the Issue Department) but Reserve Bank money increased only by Rs. 320·18 crores. The balance of the amout, Rs. 116·83 crores, was realized through reducing the non-sterling assets of the Bank, Rs. 116·14 crores of rupee securities from the Issue Department and Rs. 69 lakhs of rupee assets from the Banking Department.

The actual process of how this happened is, probably, somewhat as follows. Of the sterling received by the Reserve Bank, during the year, Rs. 310 crores worth came from the British Treasury;[31] against this the Bank had to issue rupees to their Indian agents, the Government of India. The latter, however, had been able to collect in the course of the year, through the issue of loans and post-office savings, sums in excess of its own requirements, as distinct from its commitments on British and allied account, the magnitude of which

29. The Finance Member in his Budget speech of February 1943 (p. 21) dismissed all charges of inflationary finance as being the "result of confusing cause and effect" and of "misrepresenting" certain "elementary facts".

30. See Budget speeches for 1944-45 (p. 14) and 1945-46 (pp. 14-15).

31. See Table IV, p. 15 above.

we may guess was about Rs. 116·83 crores. To this extent, therefore, it was willing to utilize the payments owing to it from the Reserve Bank for a cancellation of documents of its indebtedness such as treasury bills in the possession of the Bank. This having been done, expansionary creation of money was necessary only for encashing the balance of its aggregate sterling receipts, Rs. 320·18 crores.

The reduction in the non-sterling assets effected during the year did not, however, wholly neutralize the volume of the increase in such assets, which had taken place during the war years, so that, looking back to this period as a whole, we are not in a position to say that any portion of the war-time sterling receipts was exchanged for rupees through non-inflationary methods. From Table VIII we find that there was a net increase of Rs. 22·61 crores in the rupee investments and other rupee assets of the Reserve Bank as between March 1939 and March 1945 and the total volume of Reserve Bank money created during the interval was in excess of the accruals of sterling by this amount. The entire quantity of rupee currency issued against sterling during the period was, therefore, expansionary in character.

VIII. Summary

To summarize: The net sterling accumulations with the Reserve Bank, which we may call S, are compounded of two streams, namely, the proceeds of the overall surplus exports, which we may call E, and Imperial and allied war expenditure in India other than the cost of purchases meant for export (which would be covered by E), which we may call I. E would be made up of three elements: dollars and other foreign exchange received in payment of the surplus exported to countries outside the sterling area, Indian gold and materials purchased by the British Government directly and receipts on the sale goods to the British public and the sterling area countries. The entire amount of the receipts under the three heads would accrue to the British Treasury and the Reserve Bank would get in exchange sterling treasury bills. The magnitude of I is a measure of the goods and services acquired by the British Government from the Indian economy

for use, within India, of her own and the allied fighting services. As in respect of surplus exports, the dollar exchange accruing under this head, (representing U.S. expenditure), would be appropriated by the British Treasury. So far as India was concerned the entire amount of I may be, therefore, said to represent British expenditure as it was from Great Britain, not the U.S.A. or other allies, that we have to receive payment for it. The latter would make payments to the British Treasury, not to us. To call it British *and allied expenditure* is thus, from this standpoint, somewhat of a misnomer. From September 1939 up to 31 March 1945 the magnitude of E was Rs. 562 crores and that of I Rs. 737 crores (Table V).

During 1939-40 and 1940-41 the amounts of the rupee expenditure of the United Kingdom could be met from out of the Home Charges, which we may call H, (by asking for their payment in rupees instead of receiving them, as usual, in sterling) and from out of the rupee credits resulting from the repatriated sterling debt and other sterling obligations of the Government of India, which we may call D. During the same years a part of the overall surplus exports (Rs. 8 crores in 1939-40 and Rs. 74 crores in 1940-41) was redeemed from out of D (Table IV). But no offsetting arrangement of this kind was done in respect of the balance of the exports during these two years and the whole of the surplus exports during the following three years. With regard to war expenditure, however, a part was always met from out of Home Charges and through the repatriation of sterling debt. During 1943-44 and 1944-45, as we shall see in a later chapter, a part was also met from the proceeds of the sale of British and allied gold, which we may call G. For the rest, to raise the rupees required, recourse was had to the easy device, provided by the sterling exchange standard, of inflating the Indian currency by offering equivalent sterling treasury bills to the Reserve Bank.

Though sterling accruing to the Reserve Bank issued forth from surplus exports and the United Nations' war expenditure, the full amount of either did not come into or remain in its possession. What remained with the Bank constituted only a part of the aggregate. Since the whole of the

overall surplus exports was taken over by the British Government, either in the form of goods directly or in the form of the proceeds of their sale, and was utilized for the furtherance of its war effort, the entire amount of the rupee payments which they involved must be reckoned to form part of the British war expenditure in India. The aggregate amount of the British and allied rupee expenditure, which we may call W, would, then, be equal to the sum of I and E. And the relationship between W and the sterling assets actually in the hands of the Reserve Bank would be as in the equations below:—

$$W = S + D + G + H \quad \ldots\ldots\ldots\ldots (1)$$

$$S = W - D - G - H \quad \ldots\ldots\ldots\ldots (2)$$

In a later chapter, when we have estimated the value of G and have collected fuller information regarding the magnitude of D, we shall attempt to evaluate these symbols (Table XXIV). Meanwhile, a glance at Tables III and IV indicates that the published figures of British war expenditure in India fall short of the amounts which would result from equation (1) above. This would seem to be so mainly because the latter does, and the former does not, include payments for Indian exports acquired through the normal channels of trade or through agencies such as the U.K.C.C.

CHAPTER II

THEIR COST TO THE INDIAN ECONOMY

I. The Two-fold Aspects of the Problem

The effects on the Indian economy of the phenomenon of sterling accumulations may be considered in its two separate aspects: (1) the effects on the debtor-creditor status of the country in relation to the outside world or the external aspect and (2) the effects on the distribution of income and wealth within the national economy or the internal aspect. We shall examine the internal aspect in the present chapter and the external aspect in Chapter III.

II. Inflation Against Rupee and Sterling Assets

The effects on the distribution of income and wealth are the outcome of the inflationary issue of money against sterling. Though Reserve Bank money of an expansionary character was created also against rupee assets, the proportion of the latter, as may be seen from the table below, soon declined. It fell to 34·93 per cent in 1941-42 from the high water mark of 96·06 per cent, which it had reached in the previous year. In 1942-43, the issue of additional moneys against rupee assets remained at 3·64 per cent of the total and was as low as 1·77 per cent in 1944-45. The greatest part (Rs. 116·83 crores) of the aggregate volume of the rupee paper (Rs. 140·44 crores), however, was cancelled during 1943-44 and there remained, with the Reserve Bank, as a result, only Rs. 22·61 crores worth of these assets at the close of March 1945. That is to say, except for this amount, which represented but 1·72 per cent of the aggregate monetary expansion, Reserve Bank money issued for balancing Government budgets, Provincial and Central, may be said to have been wiped out. And the situation, to-day, is that of Rs. 1,312·06 crores of the war-time monetary expansion as much as Rs. 1,289·45 crores or 98·28 per cent, represents inflation executed for the benefit of the British Treasury, the

TABLE IX

Monetary Expansion (+) or Contraction (—) Against Sterling and Rupee Assets of the Reserve Bank

(Crores of Rupees)

	A	B	C	D	E	F
	Sterling Assets	Government Rupee Paper[1]	Total Rupee Assets	Reserve Bank Money	A as a percentage of D	C as percentage of D
1939-40 ..	+ 68·06	+ 7·60	+ 5·41	+ 73·47	91·64	7·36
1940-41 ..	+ 2·50	+ 60·22	+ 61·00	+ 63·50	3·94	96·06
1941-42 ..	+ 103·65	+ 52·37	+ 55·65	+ 159·30	65·07	34·93
1942-43 ..	+ 260·91	+ 12·70	+ 9·86	+ 270·77	96·36	3·64
1943-44 ..	+ 437·01	— 119·13	— 116·83	+ 320·18	136·49	—
1944-45 ..	+ 417·32	+ 7·55	+ 7·52	+ 424·84	98·23	1·77
Total ..	+1289·45	+ 21·31	+ 22·61	+1312·06	98·28	1·72

1. Including Rupee Securities in the Issue Department, Loans, Advances to Governments, Investments and Bills Purchased and Discounted in the Banking Department. It has been presumed that Investments do not include sterling securities and that Bills Purchased and Discounted are all rupee treasury bills, which is, probably, the case.

share of the State in India being somewhat under Rs. 1-12-0 per cent. And, since an amount of Rs. 22·61 crores of additional moneys, spread over a period of six years, would have produced no visible consequences of any significance on so vast a country, the effects of the war-time inflation in India may be all put down to sterling accumulating with the Reserve Bank.

III. The Impact of Inflation Upon Prices

In so far as appropriation for war purposes of the men, materials and things, at the expense of the civilian sector of the economy, is concerned, inflationary finance may be said to be indistinguishable from finance through loans and taxation. Under both systems alike the civilian part of the population would be deprived of a portion of their share of the consumption goods and services as well as of the means of producing them. The difference between the two would appear only in the matter of the methods of acquisition. Under the system of taxation cum loans the government would first transfer to itself purchasing power from the pockets of the people and appropriate, therewith, the things it required from the market. Public expenditure, under these conditions, would be taking place only in substitution of private expenditure on capital and consumption goods and the government may be said to be merely taking possession of what the public went without in order to be able to pay taxes and to subscribe to loans. As the aggregate volume of money flowing into the market would remain unchanged, apart from variations which may take place in individual prices, the general price-level would remain constant.

In a régime of inflation, however, public expenditure would be in addition to, not in replacement of, private expenditure, to the extent fresh moneys have been created in favour of the government. Appropriation by it of the things required for the prosecution of war would be effected through the device of outbidding the public with the aid of the inflationary funds, in its possession, that is, by offering higher prices than the public can generally afford to pay. The money stream flowing into the market, in other words, would be larger than before and the price-level as a whole would rise

TABLE X

Index Numbers of Wholesale Prices[2] (August 1939=100), Cost of living[3] (July 1933—June 1934=100), Security Prices[2] (1927-28=100) and Reserve Bank money (1938-39=100).

		Agricultural Commodities	Raw Materials	Primary Commodities	Manufactured Articles	General Index of Wholesale Prices	Working class cost of living	Price of Securities (variable yields)	Reserve Bank Money
1939-40	..	127·2	118·8[4]	123·8[4]	131·3[4]	125·4	108	111·7	131·4
1940-41	..	108·6	121·4	113·4	120·0	114·8	114	117·4	157·3
1941-42	..	123·6	146·2	132·0	154·0	136·4	128	129·0	223·8
1942-43	..	165·3	165·5	165·4	188·9	170·2	174	138·6	337·2
1943-44	..	270·6	184·9	233·3	251·7	237·2	237	182·2	471·1

2. Office of the Economic Adyiser to the Government of India.
3. *Labour Gazette*, Bombay.
4. Seven months ending March 1940.

in addition to such changes as may take place in individual prices. The table on p. 32 above conveys an idea of the impact of inflationary finance upon the Indian economy.

From the table we find that the prices of all classes of goods have risen, to a lesser or larger extent, with the progress of inflation. Excepting the prices of raw materials and of securities, which have risen only by about 80 per cent, the rest of the prices in the table have all registered a rise of over 130 per cent as compared with August 1939. Whilst this is bad enough, it does not, perhaps, depict the real situation with sufficient downrightness. The indices in India, as in certain other countries similarly placed, are somewhat unreal inasmuch as they are calculated, in cases where controls apply, on the basis of official prices which, being but imaginary, all too often, bear no relationship whatever to the prices actually ruling in the market. If the latter had been taken into account the picture emerging would be vastly worse. In particular the cost of living has multiplied several times and not merely by 137 per cent as the table above might indicate. The fact that the price indices have been tampered with would seem to provide the principal explanation of the disparity between the rate of their increase and the pace of acceleration of the monetary circulation as shown in the last column of the table.

IV. Distortion in the Pattern of Distribution

The rise in prices has brought about a ruthlessly regressive distortion in the peace-time pattern of the distribution of income and wealth. No doubt the level of wages, especially that of industrial workers, has generally risen during the period under review. But, as is only inevitable under a régime of inflation, the rise is far from commensurate with the fall in the value of money: whilst monetary circulation was being added to at the rate of about a crore per day, wages can never succeed in fully catching up prices even if they should be capable of revision more frequently than is usual. And the dearness allowances paid, when viewed in the background of the mounting cost of living, seem but tokens of sympathy and goodwill of the enlightened employers, if

they were not granted as concessions to public opinion or to the agitation of trade unions.

It is clear that the earnings in real terms of the wage-earning classes have fallen short of their legitimate share, even as determined by the pre-war standards of conomic equity. Though the amounts of the money wages plus dearness allowances were certainly higher, real wages were nevertheless lower, than before inflation began, the margin of the difference between the level before the level now being measured by the gap which separated wages from prices (cost of living). For vast sections of the working community, more especially over the countryside, this margin of difference was so large, that is, the real wages they received were so deplorably low that, their distress became boundless. They found themselves compelled to subsist on lower grades of food and clothes and also to cut down, more or less drastically, the quantity consumed of both. In an economy where the per capita income was only Rs. 65 per year (8 s. 1½ d. per month), it is quite unnecessary to enter into any elaborate statistical analysis to obtain a vivid picture of the significance of this distress. We are aware that numberless workers and their families were abandoned to starvation and death not only in Bengal but also over many parts of the rest of the country.

Nor was the fate of the salaried classes and those who lived on fixed incomes such as pensions or on savings any happier. They, too, were forced to stint, even in respect of necessaries, and economize on or forgo comforts. They could command none of the standard of living customary to them before the war.

Distributive injustice in respect of income was also accompanied by similar injustice in respect of wealth, whether currently accumulating or already accumulated in the past. For, workers and salaried men, finding prices too high, have had to expend the whole, or nearly the whole, or their income in current consumption, at one end of the scale, in order to be able to keep alive and, at the other, in the attempt to maintain the socially ordained or the accustomed standard of living. At both ends, as well as all along the line, finding the

currently accruing income insufficient, they might have also drawn upon their past savings, liquidating by sale their personal belongings such as gold and silver, hoards or other property. In both cases those with fixed money incomes may be said to be parting with their wealth as distinguished from income. This is quite clear when jewellery or other assets are sold to meet the bills arising out of current expenditure. It should be clear, too, when income which should be legitimately assigned to depreciation is assigned, instead, to consumption, as those who do so may be said to be living on their capital by instalments. Virtually the same happens when income which ought to have been allotted to savings or to the formation of capital is employed for current consumption: potential future wealth is drawn upon for use in the present.

What is thus denied to, or taken away from, those with contractual money incomes, under the head of income and wealth, would accrue, in the first instance, to the credit of a small minority, the rest of the community comprising manufacturers, entrepreneur producers and middlemen, whose incomes are principally residual and who, consequently, stand to gain from the inflationary rise in prices. Rising prices would increase the profit income of this class, which, in the main, would be none other than the losses suffered by the fixed-income groups.

They would not, however, be able to retain in their possession the full amount of the higher profit receipts. The State would appropriate the greatest portion of it through income-tax, excess-profits tax and super-tax. Apart from compulsory deposits, which are repayable after the war, in 1943, for instance, the Government of India took away from out of profits $66\frac{2}{3}$ per cent on account of excess-profits tax and $13\frac{1}{3}$ per cent on account of income-tax and super-tax or an aggregate of 80 per cent. Nevertheless, the margin left behind coupled with the black-market profits, which are believed to be substantial but which are not shown in the accounts, has contributed in no small measure towards an improvement in the economic status of this class relatively to the pre-inflation period. Their wealth and income have multiplied several times.

V. Terms of Exchange Between the Outputs of Industry and Agriculture

The transfer of economic well-being has also taken place from the primary producing occupations, principally agriculture, to manufacturing industries, or to those engaged in the latter, and from the non-rationing to the rationing areas. Owing to a combination of factors, particularly defective finance and marketing, agricultural prices in India lag behind prices of manufactured articles by a larger margin than is the case in other countries, where the agricultural industry is comparatively better off and where the administration is more actively sympathetic to the lot of the former. The net result of this is that agriculture gets less for the things it has for sale while it has to pay more for the things for which it depends upon manufacturing trades. The unfair terms of exchange between the two get intensified during periods of inflation, as agricultural prices, for the reasons we have indicated, fail to adjust themselves to the falling value of money as speedily as do the prices of manufactures. That, in fact, this is so may be seen from Table X above. Index numbers of manufactured articles, as quoted in the table, have, throughout the war period, risen faster than the index numbers of 'primary commodities', 'raw materials' and, with the exception of 1943-44, also of 'agricultural commodities'. A part of the national dividend, therefore, may be said to have been shifted from the agricultural to the manufacturing trades as a result of inflation.[5]

5. The influence of two other factors, which, however, are unrelated to, and are independent of, inflation, has also caused a similar transfer of income. First, the manufacturing industry in India caters almost wholly to the Indian market whilst the agricultural produce depends also on markets abroad (in some cases, such as cotton, to an overwhelming extent), which are to-day either closed, with the stoppage of traffic with the enemy countries, or are not freely accessible, owing to the difficulty of transport. Moreover, the fall in the magnitude of the imports of manufactures from abroad has rendered these goods more scarce than normally. Second, the war to-day being a war of machines, the demand of the fighting services on industry is more heavy and also more inelastic relatively

VI. Distributive Injustice Within the Agricultural Industry

Within the agricultural industry itself there will also have taken place a similar shifting of income as between the cultivator and the middlemen. The cultivator in India, principally owing to the smallness of his individual output, the absence of a sympathetic marketing organization and his dependence upon the moneylender for financing his agricultural operations, to whom he is often heavily indebeted and who is also frequently the buyer of his produce, is never able, in periods of rising prices, to pull his full weight and get for his produce the entire benefit of the competitive market prices. The prices he succeeds in getting follow market prices only at some distance, the middlemen appropriating for themselves the difference. On the other hand, the prices he is called upon to pay for the manufactures he has to buy, including agricultural implements and articles of consumption, are, more often than not, higher than the market prices; they are even higher than the black-market prices in the nearest town. Thus he has to bear more than the full impact of the rising price-level in his capacity as a buyer, while he gets less than the full advantages of it in his capacity as a seller. Inflation thus cuts him both ways at the same time. To this must be added the incidence of the policy of the State to purchase from him, compulsorily, at controlled prices, part of his output of food grains. When viewed as a whole, the position of the farmer generally may not, in other words, be any brighter than that of individuals with contractual money incomes. The lot of the petty farmers, who constitute by far the largest majority of the farming community, is, probably, almost as bad as that of workers in general, notwithstanding the rise in agricultural prices.

to that on agriculture, so that, the ratio of the national dividend expended by the State upon industry and agriculture would get distorted in favour of the former. That is to say, war conditions have generated forces which tend to favour industry at the expense of agriculture.

VII. Transfer of Income from the Non-Rationing to the Rationing Areas

Transfer of income has taken place, too, from the non-rationing to the rationing areas, that is, from the districts and the smaller towns to the comparatively more fortunate among the larger towns and cities, where rationing has been introduced.[6] Whilst the former have been exposed to the full blast of inflation the latter have been partially screened from its effects, inasmuch as they have been provided with the principal staple articles of foods and, latterly, also cloth at controlled prices. To the extent supplies are made available through rationing, a given income would go further in the rationed than in the non-rationed areas. In the absence of regional rationing the entire community, including the rationed areas, would share the limited supplies, the competitive market price, or, to use a more comprehensive term, the mechanism of the pricing system, being the agency for effecting its distribution. No doubt the share of each would, then, depend not upon one's needs but upon one's economic competence and willingness to pay the prices demanded; but no distinction will be drawn, on a geographical basis, between one individual's competence and that of another. All areas will be on a par with one another.

When regional rationing is introduced, however, the law of economic equity would remain suspended. The same money expenditure would bring a larger quantity of the rationed articles in the rationed than in the non-rationed areas; it would take a larger slice of one's income in the latter than in the former to meet in full one's requirements in respect of these articles. The balance of income would, therefore, be larger in the one case than in the other and those situated in the rationed areas would, consequently, be able to command a larger share of the non-rationed goods with it than those situated elsewhere. Indeed, the open market prices of the essential groups of rationed articles may be so high that, some people in the non-rationed areas may not

6. Rationing exists today in about 250 cities and towns.

have any balance left over at all for any other purchases. In extreme cases, the incomes may even prove to be insufficient to acquire enough of the bare essentials of life.

It is clear, therefore, that, if certain groups of articles are supplied at less than open market prices to some chosen sections of the people, some others elsewhere in the economy would have to go short either of those commodities or of some others. Regional rationing would render the real content of money incomes different as between the rationed and the non-rationed parts of the country. It becomes, in other words, a device whereby a greater than the legitimate share of the national dividend is made to gravitate into the hands of the people in the rationed areas at the expense of the rest of the community. The injustice of this would become more and more pronounced as inflation progresses and the disparity between the controlled prices of the rationed articles and their actual market prices widens. If so, we have here a case in which something, instead of being better than nothing, is worse than nothing. Social and economic equity, if this must apply to the country as a whole, would seem to demand that, either there should be no rationing at all or rationing must be nation-wide. There is certainly no economic or moral case for introducing rationing in the comparatively more prosperous cities and the larger towns whilst the countryside and the smaller towns were abandoned to their own fate. If, however, this was intended as part of a policy of appeasement of certain areas or was designed merely as token of the administration's sympathy by the people, it is quite another matter. The case for regional rationing would, then, rest upon political, not economic or ethical, grounds.

VIII. Shifting of Economic Well-being from India to Great Britain

Whilst these changes have been taking place within the economy, there has also resulted simultaneously a shifting of income and wealth from India to Great Britain and on a scale which, in real terms, may be said to be equivalent to the goods and services, including the surplus exports of the coun-

try, acquired by the British Government against *ad hoc* sterling treasury bills. To pay for these goods and services, in the ordinary course, would demand either a shipping of the produce of the British factories to India or a commandeering, for sale in the Indian markets, of the British-owned Indian securities or partly the one and partly the other. In either case the British Government would have had to find equivalent funds, through higher taxation, issue of more loans or more inflation in Great Britain. The method of payment in sterling saved the British citizen from the sacrifices which these alternative measures would have imposed upon him. The burden of it got shifted, for the time being at any rate, from his shoulders on to the back of the Indian peasant; which is the same thing as saying that there has taken place a transfer of economic well-being from India to Great Britain.

There is, however, a material point of difference between the transfer of income and wealth, which has taken place from the Indian to the British economy and the transfer as between the various elements within the Indian economy itself. Whilst the latter is a permanent transfer, in respect of the former, the payments received in sterling are capable of being converted into goods, from Great Britain, or, at her expense, from the outside world, after the war. To the extent this may happen, the transfer would be merely a loan, though a forced one, from the one economy to the other. Part of the transfer, however, may not come back at all. To this will belong the loss resulting from the depreciation of sterling. To it will also belong such amounts of sterling as may be written off or as would be distributed as an exchange bounty to the exporters of British goods to India through the over-valuation of the rupee.[7] Further the individuals from whom the loan would be extorted (those who have suffered on account of inflation) would be different from the individuals to whom the repayment would be made (the profit-earning classes whom inflation has enriched).

7. See p. 147 below.

IX. Post-war Repercussions

The policy of sterling accumulations and the issue against them of expansionary currency or credit would also have repercussions of a serious character upon the stability of the economy after the war. As I have examined in some detail elsewhere,[8] the inflationary funds in the possession of the entrepreneurs might mislead them into launching, once the war-time restrictions were removed, over-ambitious schemes of economic expansion. Impressed by the volume of the financial resources in their possession, they might consider themselves powerful enough to rebuild their respective enterprises not only to the pre-war level of their capacity but also to take them appreciably beyond that stage. In their aggregate, however, the individual programmes of expansion are likely to mount up to a magnitude which would be quite beyond the capacity of the economy to implement successfully.

For, on the termination of the war, the economy would be in a state of utter exhaustion. The stock of its real capital goods would be in a badly worn condition; besides, those in working condition would be also smaller than before the war; the aggregate productive capacity of the country's capital equipment as well as its average co-efficient of efficiency would, in other words, be below their pre-war norm. The output of the raw materials of production, too, will have suffered appreciable diminution as a result of the slaughter tapping of plantations, the raising of exhausting crops and deforestation. The existing physical resources, therefore, would not permit the immediate attainment of even the pre-war level of production.

For these reasons, it is not possible to expect that, forthwith upon the unwinding of the Indian economy from war to a peace basis, it will be in a position to settle down to producing, or to obtain in exchange for its output from the outside world, the same quantity of capital and consumption goods as it had been doing before the war. To assume that

8. *The Post-war Depression and the Way Out.*

it will be able to do so would be tantamount to saying that our railways, rolling stock, the roads, the factories, the buildings, the machinery, the farms, the estates and the mines have not deteriorated in quality or efficiency as a result of the strain and the heavy wear and tear to which they have been subjected by the war.

The shortage of the physical resources, however, is not likely to be taken serious notice of by the individual entrepreneurs, each one of whom is more likely to be misled by the financial integrity of his own position and the vastness of the monetary funds and investments accumulated to his credit. If so there would be a wide disparity between the aggregate requirements of the individual plans of development, on the one hand, and the available productive resources in the economy, on the other. To begin with, however, while yet the process of unwinding the war economy would be in progress and the men, machines and materials hitherto engaged in the war trades would be available for employment, the shortage may not be apparent to the naked eye. For a brief while even a contrary illusion may be created: the crisis of the rush of demobilization over, employment would be easy to obtain, incomes would remain high, civilian production would begin to mount up and there may not be visible any external evidence of the divergence, such as that we have indicated, between the demand for, and the supply of, resources. Instead, the economy would, probably, be experiencing conditions akin to a boom.

This illusion, however, cannot last long. For, as the projected plans would be progressing towards completion, the fact of the physical shortages in the economy would become more and more apparent and the mirage of the war-time riches, on which the plans had been based, would begin to reveal their unsubstantial character. This would happen somewhat as follows. The withering away of the war trades will have been completed before long and the factors of production thereby made available will have been all absorbed into employment. At this point, as the plans will not yet have been completed, there will ensue a struggle among entrepreneurs for the factors of production and the price of the latter will begin to move up if it had not done

so already. When this happens, the balance of the war-time funds remaining in the hands of the entrepreneurs will be found to be insufficient to see them through the programme of expansion successfully. The scramble for funds and for the physical resources, which will now gather momentum, will intensify the difficulties of the situation and the more unfortunate among the entrepreneurs will be forced into liquidation. Thereupon panic will spread and also deepen, on lines which are familiar, and the economy will slip down into the grips of a depression.

This instability would form part of the cost, to be borne by the Indian economy, of the policy of financing Imperial expenditure through inflating Indian currency. And, if the instability is sought to be avoided through the retention of the necessary economic controls, the price we must pay would only take the form of the hardships which would attend the controls. It would not be possible to evade the cost altogether.

X. Summary

To summarize: Inflation, or, to go to its root cause, finance of British and allied expenditure in India through offering sterling to the Reserve Bank, has worked havoc with the pre-war pattern of the distribution of income and wealth. Iniquitous as that distribution had been, inflation has made it more so. The economic gulf between the workers, the masses of the population and the fixed-income groups generally, on the one hand, and that of the profit-earning fractional minority, on the other, has been widened. The terms of exchange between the output of agriculture and of other primary producing trades with the industrial output have changed for the worse, to the detriment of the former and to the advantage of the latter. Within the agricultural industry itself the middlemen have gained at the expense of the farmers, especially the petty farmers. Transfer of well-being has also taken place from the countryside and the smaller towns to the larger towns and cities which have had the benefit of rationing. It has been a case of entrepreneurs living upon wage-earners, industry living upon agriculture and other primary producing trades, middlemen living upon

cultivators, rationed areas living upon non-rationed areas and the United Kingdom, for whose benefit inflation has been indulged in, living on top of them all.

The cumulative effect of all this has been that the living standards of the poorer classes and of the lower grades of the fixed-income groups has been rendered more wretched than ever. The starving man has been made to eat less and starve more in order to relieve the burden on the British tax-payer. The incidence of it, however, might have been distributed more equitably in accordance with the doctrine of ability to pay, if the Indian contribution to the British national war fund had been brought within the purview of the Indian budget and the requisite finance had been raised by taxation and loans, though, it must be added that resort to these methods on so large a scale may not have been practicable in the absence of a truly national government. It might have, however, spread the suffering more evenly over the community as a whole and might have, consequently, prevented deaths through starvation in such large numbers. Actually, owing to the crude device of resorting to the printing press, the heaviest burdens came to be imposed on shoulders least able to bear them.

The post-war consequences of the policy are also no less unhappy. If the inflationary funds in the possession of the entrepreneurial classes were allowed unbridled freedom of action, they are most certain to jeopardize the stability of the economy. If, on the other hand, they must be rendered innocuous, the war-time regimentation of the economy would have to be prolonged into the post-war world. That is to say, either we leave it to nature to rid the economy of the harmful legacies of inflationary finance through upsetting its equilibrium or we subject it to the rigours of State controls. There does not seem to exist a third choice. Playing with the medium of exchange, like playing with fire, must necessarily be attended with perils.

CHAPTER III

THE STERLING ASSETS AND THE DEBTOR-CREDITOR STATUS OF THE COUNTRY

I. The Official View

Whilst the analysis of the preceding chapter would seem to show that the phenomenon of sterling accumulations has been wholly an unmixed evil, it has been claimed by many that these accumulations have turned the country from a debtor into a creditor. If this change in our status has, in fact, materialized, we may be said to have derived a very real gain from the suffering and the injustice which we have gone through during the past several years. For, a creditor position is usually associated with economic riches and a growing standard of living; the transformation, therefore, should prove a source of great comfort to everyone inasmuch as it may, then, be said to mark the end, or the beginning of the end, of our chronic poverty.

Since, however, the supposed fundamental change was ushered in only through the agency of the printing press and since it is hard to believe that downright inflation can produce any economic progress of a permanent character, it would be worthwhile examining the real content of the claim. For acceptance of it is tantamount to saying that, notwithstanding the teachings of economic theory to the contrary, the simple process of multiplying the number of money coupons is after all capable of working out, in practice, economic miracles of no mean order.

The theory that India is now a creditor country was, I believe, first advanced by the Honourable the Finance Member in his (1943-44) budget speech to the Legislative Assembly in February 1943. After reviewing the repatriation of the sterling part of India's public debt already completed since the outbreak of war, and after outlining the programme of repatriation for the budget year, Sir Jeremy Raisman observed that 'India has completed the transition from a debtor to a creditor country and extinguished within the brief space of about three years accumulations over decades of its *public indebtedness*[1] to the United Kingdom'.[2] As the

1. Italics mine.

2. *Budget for* 1943-44, p. 18. The sterling liabilities of the Government in February 1945 amounted to only £11 million. They remained

statements, a few paragraphs below, in the same speech make clear, the implication of the words we have quoted above would seem to be that since, even after extinguishing Governmental indebtedness to the United Kingdom, there still remained with the Reserve Bank an amount of sterling which was in excess of what was likely to be required by it as a reserve against its note issue, the debtor-creditor relationship between India and Great Britain may be said to have been reversed.

A similar statement was made by the Honourable the Financial Secretary in the Council of State. Said Sir Cyril Jones: 'Thus has India ceased to be a debtor country, and there can be little doubt but that she will find her creditor position a distinct advantage in the post-war world, apart from the relief she has secured of the necessity of providing every year for meeting her public charges'.[3]

This official lead on the subject soon found a large body of following. The idea was taken up and broadcast by the Anglo-Indian press and was also echoed, parrot-like, by some Indian economists[4] and publicists. In the process its use became quite indiscriminate. The Finance Member's statement might be said to have applied merely to the debtor-creditor position in the restricted field of Governmental indebtedness. But this circumspection disappeared when the statement was repeated by the Financial Secretary and very soon the term creditor country came to be freely employed in the same sense in which it is understood when applied to Great Britain or to the United States of America.[5]

behind either because their holders, being resident outside the Empire, did not come within the scope of the vesting orders or because the scrips were not surrendered for redemption. See *Budget for 1945-46*, p. 16.

3. *Budget for 1943-44*, p. 57.

4. See V. K. R. V. Rao, op. cit. pp. 147-49; Research Staff of Gokhale Institute of Politics and Economics in *India Quarterly*, January 1945, p. 41.

5. Dr. V. K. R. V. Rao, for instance, has used the term in this sense (op. cit., p. 149). Likewise the 'Victory Service' propaganda sheets issued by the Bureau of Public Information, Government of India, (10 March 1945, p. 14) began to speak of the 'emergence of India as a creditor nation' as being 'one of the outstanding results of the war'.

II. Definition of a Debtor-Creditor Status

To begin with we must be, therefore, clear in our minds regarding the general implications of the term debtor or creditor country. It would be helpful, too, to have a vivid outline picture of how a country may build up a creditor position or how a debtor country may rise to the status of a creditor.

A country may be properly described as a debtor or a creditor not merely by reference to the external indebtedness of its government but by reference to the final debit or credit position of the sum total economy vis-á-vis the outside world on account of capital and credit, including, no doubt, governmental indebtedness. Due notice must be taken, that is to say, also of the foreign assets owned by nationals and the assets within the frontiers of the country owned by foreigners, over the whole field of economic activities embracing trade, agriculture, industry, transport and finance, before the economy may be adjudged a debtor or a creditor. The government of a country, for instance, may be free from external debt, but the country as a whole may, nevertheless, be a debtor if the debits under other heads should exceed the corresponding credits.

The basic principle underlying the manner of how a country may come to acquire assets abroad is easily seen. To begin with short-term credits are built up in money centres abroad through creating surplus exports, using the latter term to include visible as well as invisible items of trade. This may be done either by exporting the things made available through reduced consumption at home or by refraining from importing goods up to the full extent of the exports. In either case the resulting short-term credits abroad may be said to represent the savings on the part of those who, through their abstinence, enabled the increased exports or the reduced imports to materialize. They may also be viewed as the savings of the community transported into the international sphere, that is, the international savings of the economy. And, even as in the case of savings held in the form of bank deposits or treasury bills within the country, the income to be derived from short-term funds held abroad being only nominal, their owners would seek an early opportunity to convert them into

long-term assets such as government bonds, shares or debentures in a joint stock or partnership concern.

It is, of course, not necessary that those who, in the first instance, may own the foreign credits need also be the parties owning the ultimate investments. The latter, who may have had nothing to do with the former, may acquire the credits from the exchange market with which to purchase the foreign assets. It may also happen that the investments purchased are in countries other than those where the proceeds of surplus exports were kept. The final result in all cases, however, would be the same: nationals within the country would come to own titles to the productive equipment of the economies in other lands. This, in broad outline, was the process of how Great Britain, for instance, had built up her vast overseas investments in India, in the Colonial Empire, in China, in South America and elsewhere. And, political expropriation and indemnities apart, there is no other device of doing so. When the amount of the investments, and such of the short-term credits as may have remained uninvested, exceed in the aggregate the amount of the investments at home by foreigners, the country may be said to emerge a creditor. In the opposite case it would remain a debtor.

III. Short-term Credits in Foreign Centres and the Debtor-Creditor Status

Though the above definition takes notice of net short-term funds as well, actually, in normal times, their average magnitude would be negligible in respect of debtor as well as creditor countries. For, as we have seen, the owners of these balances would be eager to convert them into long-term investments, as soon as they grow beyond a certain limit. In respect of countries which have debts to pay, this will lead to their being utilized for cancelling external indebtedness. To pile them up would put the country in the queer position of having to pay to its foreign creditors the long-term rate of interest (ruling at home) while it would receive from its foreign debtors only the short-term interest rate (ruling abroad), which would be but a fraction of the former.

This state of affairs may not develop without attracting public notice and, in the case of sovereign States, without the government stepping in to rectify the situation by devices such as negotiation, discriminatory taxation on the foreigners' income from investments,[6] or by statutorily imposed repatriation. Ordinarily, therefore, the volume of the short-term credits may not exceed the amounts necessary for payments on account of interest, dividend or sinking fund, the surplus over and above this being utilized either for redemption of the debt or for long-term investments abroad. That is to say, liquid funds held by debtor countries in foreign centres would, normally, form but a fraction of their aggregate net indebtedness; they would not change their debtor status though the magnitude of indebtedness may be reduced somewhat.

For corresponding reasons the same would apply to creditor countries as well. Assuming circumstances to be normal, creditor countries may not succeed in piling up surplus (consumer) imports indefinitely so that the short-term credits raised in foreign centres to pay for them exceeded their long-term assets abroad. Such imports would be an indication that some people in the economy were living beyond income. And, in order to clear the accumulating bills, sooner or later, they would be compelled to liquidate their assets; this, through depressing their price, might induce the owners of foreign investments to exchange their foreign assets for comparable assets at home. When this happened, the short-term debts of the country would be cancelled against equivalent foreign investments. The process would be hastened, too, by the creditors abroad demanding payment. Normal circumstances prevailing, it is not possible, that is to say, to go on accumulating short-term indebtedness on the one hand, and, at the same time, retain possession of the long-term foreign investments. This amounts to the same thing as saying that the volume of the short-term debts of a creditor country may not be large enough to change its creditor position into that of a debtor.

6. This device was adopted by the Union of South Africa during World War II. See p. 134 below.

Furthermore, since a creditor status implies that, on balance, an income would accrue to the economy from its overseas investments,[6a] a mere numerical excess of short-term credits over the nominal or the market value of long-term indebtedness cannot be said, at once, to convert the country into a creditor, from this standpoint. To be a creditor on income account, the volume of the short-term credits must be large enough to yield a return which would more than pay for the service obligations on the long-term debts of the country. And, the short-term interest rate being but a fraction of the yield on long-term investments of comparable category, the short-term credits would have to be a multiple of the long-term indebtedness. If, for instance, the market value of the latter was £500 million, the interest payable on it was 5 per cent and the short-term interest rate was one per cent, the magnitude of the short-term credits would have to exceed £2,500 million before the country may be classed a creditor or income account. Accumulation of credits on so stupendous a scale may be at once dismissed as a practical impossibility.

The common practice of adjudging a country a debtor or a creditor by reference merely to its long-term capital obligations has, thus, the support of economic logic. The net short-term credits of debtor countries or the net short-term debits of creditor countries, if these should represent voluntary savings of individuals over which they have an absolute right of disposal, can never be large enough to neutralize the debtor position of the one or the creditor position of the other. It will be noted that this does not, in any way, conflict with the presence, in times of depression, of vast quantities of international short-term funds, which, at the end of 1929, for

6a. In 1938, the last year for which estimates on the subject have been published, overseas investments (£3,292 million) brought to Great Britain an income of £185 million (Rs. 247 crores). See Sir Robert Kinderseley, 'British Overseas Investments', (*Economic Journal*, December 1939, p. 693 n.). And, in recognition of the principle that a creditor position would be without any significance of it brought no income to the country, Sir Robert Kinderseley has excluded from his estimates such of the British investments as stopped yielding income either through default or moratorium.

instance, was estimated to be not less than £1,000 million.[7] But these funds represented the international savings of creditor countries mainly, and not those of debtor countries. They cannot, therefore, be said to provide any evidence against our argument. Nor does it conflict with the fact that international money centres, which must be creditors, find it necessary to hold in liquid form large amounts of funds.

The above, however, is no more than the appropriate version in the sphere of international finance of the simple and self-evident truths relating to private individual finance. An individual will not readily permit the loans he has raised at, say, 9 per cent or more, to remain unredeemed while his bank balance persisted in excess of his normal requirements. He would utilize the surplus to cancel his debts. So will a nation, which had sovereign powers over its own affairs, not permit foreign credits to accumulate beyond measure while it had long-term debts to pay to the outside world. Again no individual can succeed in living above income beyond a point at which his accumulated bills equal or exceed his long-term assets without being compelled to sell the latter. Even so will a creditor nation not be able to pile up indefinitely short-term liabilities abroad. Ordinarily, therefore, the debtor or the creditor position of an individual, as revealed by his long-term assets or liabilities, will not be reversed when account is also taken of his short-term debits or credits. The same is also true of a nation.

IV. The Debtor-Creditor Position, National Economic Development and the Rate of Interest

One of the implications of a creditor position is that the returns to be had in the capital-exporting country for new investments are generally lower than the corresponding returns obtainable in the capital-importing country. Otherwise there could be clearly no case for a movement of capital on any large scale. Moreover the difference between the two returns must be deemed, by the owners of capital, to be at least sufficient to counter-balance the disadvantages,

7. J. M. Keynes, *Treatise on Money*, Vol. II, London, 1930, p. 316.

supposed or real, of holding investments abroad, including the possible loss which may result from political disturbances or war. In respect of capital moving from one part to another of the same empire, for instance, from Great Britain to India, the risk factors may, no doubt, be of lesser consequence than in respect of the movement of capital to an entirely foreign State such as Mexico. Nevertheless, some difference in the returns would have to be there to compensate for the disadvantages of overseas investments, if capital must flow out of the country freely. The long-term interest rates between the capital-receiving and the capital-exporting countries, in other words, must necessarily differ from one another by a smaller or larger margin. That this is so in practice may be seen from the table below:—

TABLE XI

Prices and Yields of British Government, Securities and Securities of Dominion and Foreign Governments

(£. s. d.)

	2 January 1935		8 January 1936		6 January 1937	
	Price	Yield %	Price	Yield %	Price	Yield %
BRITISH						
Consols 2½%	93½	2-13-6	86½	2-17-10	84½	2-19-2
Do. 4%	118	2-17-6	114½	3- 1-0	112¾	3- 3-0
INDIAN						
India 2½%	85	2-18-10	75	3- 6-8	72	3- 9-5
Do. 3½%	99½	3-10-4	97	3-12-2	98½	3-11-0
DOMINION						
Canada 4%	107	2-13-9	104	3- 6-0	105	2-13-4
South Africa 5% 1945-75.	117	3- 4-6	115	3- 4-5	114	3- 3-8
FOREIGN						
French 4%	28½	4- 9-0	25	4-14-0	17½	5- 8-7
Belgium 7%	110	6- 3-0	109	6- 1-0	—	—
Japan 5½%	86	6-11-7	88	6- 5-0	81½	6-15-0
Brazil 5%	82	6- 2-0	65½	7-13-0	85	5-17-8

The table makes it clear that, for the British investor, the yield on British securities is the lowest, that on Indian and Dominion securities is somewhat higher, while the yield on foreign securities is invariably the highest of all, being as much as £4-14-0 per cent and £7-13-0 per cent, in January 1936, in the case of France and Brazil respectively. British capital, that is to say, insists upon an appreciably higher rate of return from non-Empire than the Empire countries. Within the Empire itself it is content with a nominally higher yield than on investments at home.

A lower interest rate in the capital-exporting country and a higher interest rate in the capital-importing country, in its turn, would imply that the economic development of the former has attained a commensurately higher standard than that of the latter. When the national economy is comparativelly undeveloped, there would be a shortage of capital at home and in face of the many projects of promise, which would be awaiting the accumulation of enough savings, the urge to export capital may not appear at all. It may not appear until the domestic economy was sufficiently well developed and the marginal returns on new investments at home declined to below the returns obtainable elsewhere. Until then, though the volume of national savings may continue undiminished, a free margin of foreign credits may not be available for investment abroad for the reason, namely, that such credits would be at once converted into capital goods, materials and experts, which the implementation of the investment programme at home would demand. Almost the entire amount of the national savings, in other words, would be absorbed internally, little or no part of it being allowed to assume the form of international investments. Exceptional cases of individuals apart, national capital is not likely to seek an outlet abroad on any appreciable scale.

This may be said to be amply borne out by the fact that creditor countries generally, especially the leading ones among them, are also the most highly developed economically. The returns on investments, that is, the long-term interest rates, prevailing in them, are also lower than in the outside world, especially the undeveloped economies. On the other hand, none of the economically backward countries are

creditors. There is no creditor nation either in Asia or in South America; the capital which these economies are able to generate is insufficient to meet their own internal requirements to think of their utilizing them for building up assets abroad.

V. How Debtor Countries may become Creditors

The process of how debtor countries may liquidate their indebtedness and get transformed into creditors is, in essence, similar to that of how countries, not having been debtor countries, may build up a creditor position. To begin with, they must cancel their indebtedness either by buying off their creditors or by acquiring equivalent investments abroad. If the foreign creditors must be bought off, the prices at which the latter would be willing to part with their investments and the prices at which the nationals of the country would be prepared to buy them must meet. Situations of crisis and forced sales apart, sellers would base their price on the rate of interest ruling in their own country, while the buyers would value the investments at the interest rate they are familiar with. If the rate of interest in the creditor country is 3 per cent and that in the debtor country is 6 per cent, a security yielding an income of Rs. 12 per annum may be priced at Rs. 400 in the creditor country, if we may ignore the allowance to be made for the investments being situated in a foreign country. On the other hand, it may not be considered worth more than Rs. 200 by the investors in the debtor country. The supply price being far in excess of the demand price, the sale we are contemplating, may not, then, materialze. Even assuming the availability of the requisite amounts of foreign credits, the debtor country will not think it worthwhile buying off its creditors. Rather than purchase the foreign owned assets at, what may be deemed, exorbitant prices, it would do very much better, if it employed the resources it has conserved in fresh investments at home. Foreign credits, therefore, are more likely to be converted, by the savers, into factors of production for further development of the national economy than for buying off the creditors of the country.

This preference for investment at home will continue until the comparatively more profitable channels of new investment have been sufficiently attended to and the country has travelled some distance in the direction of national economic development. The limit of the distance to be travelled before redemption of the external debt may become worthwhile would be marked by the line of development at which the marginal returns on new investments in the debtor country would be more or less equal to the corresponding returns in the creditor country. At this stage, the rate of interest in the debtor country will have fallen to the appropriate level, which would raise the demand price of foreign investments to the level of their selling price. Since, however, investments abroad would be ordinarily rated lower, by a smaller or larger margin, than the comparable investments at home, it is not necessary that the two rates should be identical. The rate in the debtor country may remain somewhat higher, without being a hindrance to repatriation. In the example we have given above, if the allowance for the comparative disadvantage of owning investments abroad may be put down at Rs. 50, it would suffice if the rate of interest in the debtor country declined to $3\frac{3}{7}$ per cent while the interest rate in the creditor country remained at 3 per cent. The supply as well as the demand price for a security yielding a dividend of Rs. 12 would, then, be both Rs. 350 and the situation may be said to be sufficiently ripe, economically, for the country to proceed to cancel its external indebtedness.

The comparative advantages of fresh investments at home having now disappeared, generally speaking, it would be a matter of indifference to the savers whether they invested their savings at home or employed them for acquiring the old investments within the country held by foreigners. In the circumstances some savers might possibly prefer the latter course. In this choice they may be guided by one or more of several considerations. The old investments concerned may be, for instance, in a line which is familiar to them; the firm or the industry to which they refer may be located in their near vicinity; they may be of the view that the investments they are interested in are

likely to rise in value in the near future; or, it may be that the firms concerned have built up certain positions of advantage and they may, consequently, be in special favour with the investing public.

The decision to employ the current stream of savings for the acquisition of old investments will, however, be attended with certain results. The new investments which these savings might have been instrumental in bringing about, had it not been for their diversion for the purchase of the foreign-owned existing investments, will not now be embarked upon. The consequences of this would be two-fold. First, the machines and materials which might have been imported from abroad for implementing the new investments will no longer be indented for. Second, there would be available for export a quantity of investment materials and things of domestic production which would have been required for purposes of the forgone new investments but which would now be out of demand. The resulting increase in exports and the reduction in imports will create a free margin of foreign credits which would, clearly, be equivalent to the savings withheld from new investments: they would represent, in fact, domestic savings transported into the region of international finance through the device of foreign trade. Implementation of the decision to buy off the external creditors of the country is now an easy next step. The erstwhile foreign holders of the investments at home would be handed over the foreign credits in exchange for the title to these investments which they would now surrender.

To round off the narrative, if we may assume that the sale proceeds of the overseas investments would be employed by their sellers for fresh investments in their own national economy or elsewhere, they would now require instrumental goods and materials for doing so. They may, therefore, be expected readily to step in and make good the deficiency in the demand for these goods which resulted from the preference of the savers in the debtor country for old investments in place of new ones. Producers' goods exported by the latter, as well as those which it abstained from importing, may, in this manner, come to be employed in creating new investments abroad. Repatriation of a country's indebted-

ness, in effect, therefore, may be said to amount to forgoing further investments at home in order to enable its creditors abroad to replace the investments which they have surrendered by fresh investments either in their own country or elsewhere.

The progress of the process of repatriation, however, would be limited by, on the one hand, the demand for repatriable investments on the part of the savers at home, that is, by their preference for old investments, and, on the other, by the preference of the sellers for new investments in place of the old. Assuming that the effective supply of savings wanting to exchange against the foreign-owned domestic investments is not a restricting factor, the preferences of the foreigner would set the pace of repatriation when the materialization of it is left entirely to market forces untempered by State action or interference of any kind. It is possible, therefore, that, notwithstanding the local demand for them, the most highly remunerative among the investments may continue to remain in foreign hands. This need not, however, stand in the way of the country liquidating its debtor status. The debtor status may still be liquidated if capital continued to leave the country and acquired, with it, investment assets abroad. When the amount of such acquisitions equalled the amount of the foreign investments in the country, its balance of indebtedness would be zero. And, if capital should continue to be exported beyond this point, the country would gradually become a creditor.

VI. The Liquidation of External Indebtedness and the Monetary Circulation

The effect of this economic transformation in the sphere of currency, prices and exchange may be described as neutral. On the one hand there will accumulate in the foreign exchange market a free margin of foreign currencies and, on the other, there will accumulate, in the banks at home, equivalent unused savings. Since the free margin of foreign currencies would represent the overall surplus exports of the country, in the ordinary course, the owners of these exports would be paid in freshly created central bank money issued against

the foreign credits offered to the central bank. But before this may happen, the savers, in all probability, would step in and purchase the foreign credits for acquiring the foreign investments with, in which case the exporters would be paid from out of the accumulated savings of the savers instead of in newly issued currency. The savers would, then, get in exchange for their savings the foreign-owned domestic investments and the volume of the monetary circulation at home would remain unaffected.

Even if central bank money was created in the first instance, monetary expansion need not, in fact, result, as the new moneys would be cancelled as soon as the savers decided to purchase the foreign credits, which they would now have to do from the central bank instead of from the exchange market.

The price-level at home need not be affected because, if the national demand for investment goods has fallen by the amount of savings drawn away from new investments, this would be balanced by an equivalent increase in the foreign demand for them. And, the demand for foreign exchange being equal to the supply, repatriation need not exert any adverse influence upon the external value of the currency unit either.

VII. Existing Estimates of Foreign Capital in India

In the light of the foregoing discussion we may proceed to examine the debtor-creditor position of India at the present moment. India has been, since the days of its economic development under British rule, a debtor country. Large volumes of British capital have been invested in Government and municipal bonds, in railways, the coastal shipping trade, banks, insurance companies, mines, tea estates, cotton textile and jute mills, iron and steel industry, departmental stores and so on. In fact it would be difficult to find a lucrative field of economic activity in which British capital has not got some share, large or small. In addition, Britishers also own house and building properties, especially in the

larger cities and towns, besides agricultural land and other estates.

Estimates of the aggregate amount of the foreign capital invested in India are, however, merely in the nature of guesses and relate, besides, to the pre-war decade. There are no official statistics on the subject. For the year 1929 Mr. G. D. Birla put the amount at £1,000 million.[8] Mr. Findlay Shirras, however, thought this figure to be too large. He did not believe that foreign investments in India could be larger than £500 million.[9] But this latter estimate would seem to be very much below the mark among other reasons because it excludes investments held by resident foreigners, debenture capital of foreign companies, the foreigners' share of the rupee capital of companies registered in India and has made but scanty allowance for capital in partnerships and firms, in titles to buildings, landed properties,[10] etc.

Similar objections may be advanced against three other British estimates as well. Since he is here only on a spiritual mission, the Britisher would seem to be rather fond of understating the material stakes he has in this country. The *Financial Times*, London, put the amount, for the year 1930, at £583 million[11] or only £83 million more than the estimate of Mr. Findlay Shirras. And *The Economist*, after some elaborate calculations, arrived at a sum of £354 millions[12] for the year 1928-29. It is not clear how so well informed a journal could put the figure at so low a level. The sterling part of India's public debt alone stood at £354 million in 1929.[13] But somehow *The Economist* has shown under this head, with which it has coupled

8. *Economic Journal*, September 1932, p. 485.

9. *Economic Journal*, December 1932, p. 572.

10. *See V. K. R. V. Rao*, The Indian Balance of Trade, *Economic Journal*, March 1933, pp. 170-71.

11. Quoted by Mr. Findlay Shirras in *Economic Journal*, December 1932, p. 573.

12. *The Economist*, 1 March, 22 March, 18 October, 25 October and 15 November, all of 1930.

13. *Report on Currency and Finance*, 1943-44, p. 88.

municipal capital, only a sum of £219 million. Even Mr. Findlay Shirras valued it at £339·4 million. It is interesting to note that, only a week before the publication of the estimate we have quoted, the same paper, in an article prepared in its office, had believed that 'the total investment of British capital in India amounted to not less than £700 million'.[14] And it did not then think this 'an unduly large sum'.[15]

The third British estimate is that of Sir Robert Kindersley. In his eleven annual studies of the British overseas investments relating to the years 1926 to 1938, published in the *Economic Journal*, he has given for two years, 1931 and 1935, a geographical distribution of these investments. The amounts (nominal value) invested in India and Ceylon under five several heads of classification are as under :—

TABLE XII

Sir Robert Kindersley's Estimates of Overseas Capital in India and Ceylon

(£ Million)

	A	B	C	D	E	F
	Government and Municipal	Railways	Public Utilities	Mines	Miscellaneous	Total
1931 ..	261	90	12	14	81	458
1935 ..	256	84	7	12	79	438

14. *The Economist*, 22 February 1930, p. 417.
15. Ibid.

The figures in this table exclude[16] (a) securities which are not quoted on the London Stock Exchange and (b) investments in partnerships, firms and proprietary holdings of Britishers resident in India. Sir Robert Kindersley has given no indication of his views regarding the approximate magnitude of the capital under category (b) beyond stating that should these amounts be included in the estimates the 'total investments in India and China would have to be substantially increased'.[17] He is more precise with regard to category (a) which, he thinks, may be worth about 15 per cent of the total investments, the estimates given in column F of Table XII being only about 85 per cent of the total. On this basis Sir Robert Kindersley's figures would have to be altered to £533 million for the year 1931 and £515 million for the year 1935, so as to cover investments excluded under (a).

Like the other British estimates, Sir Robert Kindersley's figures, too, may be said to underrate the actual position. The sterling debt of the Government of India alone amounted to £388 million in 1931 and £384 million in 1935. But the amount allotted, by Sir Robert Kindersley, for the two years under the head 'Government and Municipal' capital was only £261 million and £256 million or below the correct amount by £127 million and £128 million respectively, even without making allowance for the fact that the amounts given by Sir Robert include municipal capital.

Under-estimation exists also in respect of the volume of the commercial and industrial capital. The total amount of the paid-up capital of joint-stock companies registered elsewhere than in India, but working in British India (excluding Burma), was of the aggregate value of £702 million in March 1931 and £546 million in March 1935. These figures, no doubt, include also the capital of companies which do the main part of their business in other parts of the world. But the paid-up capital of companies, which by their very nature must be operating principally in India, alone totals up to £218·82 million in 1931. To this must be added the

16. *Economic Journal,* June 1933, p. 200.
17. *Economic Journal,* June 1933, p. 200.

loan capital of these companies plus part of the paid-up capital of such among the companies of the following classes of description, as do the main or part of their business in India, namely, Banking and Loan, Insurance, Navigation, Transit and Transport other than Railways and Tramways, and Trading and Manufacturing Companies. It would seem difficult, therefore, to accept Sir Robert Kindersley's estimates of £197 million and £132 million on account of industrial and commercial capital for the years 1931 and 1935 respectively.[18] If these figures may be deemed to be £30 million too low Sir Robert's estimates of the total British capital in India, excluding private capital under category (b), may be further revised to £690 million for the year 1931 and £673 million for the year 1935. The securities quoted on the London Stock Exchange, on which Sir Robert's figures are based, are but an inadequate guide to the magnitude of foreign capital in India.

VIII. An Estimate of Foreign Capital in India in 1939

The foregoing estimates being old and also otherwise unsatisfactory, we may attempt to formulate an estimate of our own of the amount of foreign capital in India. Overseas investments in India may be considered under seven several heads of classification as follows: (1) sterling debt of the Government of India; (2) capital of joint-stock companies registered elsewhere than in India but working principally in India; (3) municipal and port trust loans; (4) capital of joint-stock enterprises doing business in India as well as elsewhere; (5) capital of rupee companies registered in India and working in India; (6) investments in rupee securities; and (7) capital in partnerships, firms, buildings, landed properties, etc. Statistics for later years not being easily available, we shall relate our estimate to the year 1939.

18. Mr. Birla's figure of £200 million, so far from being an over-estimate, as imagined by Mr. Findlay Shirras, would seem to be the

Ascertainment of the amounts under items (1) and (3) above present no difficulties whatever. Official statistics state the sterling part of India's public debt, at the close of March 1939, to be Rs. 469·10 crores,[19] which comes to £351·81 million at the rate of 1s. 6d. per rupee. And the amount of the Municipal and Port Trust borrowings as given in the *Investor's India Year Book*, 1940-41, totals up to £8·67 million.

Information regarding items (2) and (4) may be derived from official statistics relating to joint-stock companies in India. Of the companies listed in the statistics,[20] those relating to tea and other plantations, jute, cotton, sugar (including jaggery) and coal mining, which, in 1939, numbered 217 with an aggregate paid-up capital of £33·53 million, from their very nature may be presumed to be working wholly in India and would, therefore, fall under category (2) of our classification. To the same category would also belong companies described as 'railways and tramways', 'other transit and transport' and 'other companies'. Their total number in 1939 was 50 with a paid-up capital of £42·14 million or an average capital of £840,000 per company. In view of the smallness of this average size, which will not permit the establishment of substantial interests in more than one country, we may presume that their activities outside India may be only about 5 per cent; that is, 95 per cent of their capital. (£40·04 million) may be reckoned to have been invested in India. The total foreign capital under the second head of our classification would, thus, amount to £73·57 million.

In respect of the remaining groups of companies[21] which would fall under classification (4), the Indian activities would represent varying proportions of their aggregate world activities. At one end of the scale we have Insurance Com-

19. *Report on Currency and Finance*, 1943-44, p. 88.

20. *Statistical Abstract for British India*, 1930-31 *to* 1939-40, p. 513.

21. They are as under:—1. Banking and Loan, 2. Insurance, 3. Navigation, 4. Trading and Manufacturing Companies, 5. Mining and Quarrying Companies other than Coal Mining and Gold Mining, and 6. Estate, Land and Building.

panies whose Indian interests are, probably, fractional and at the other end we have some among the Banks and the Trading and Manufacturing Companies, with appreciable proportions of their business in India. The rest of them, probably a considerable majority, would fall somewhere between these two extremes. In the case of insurance companies generally we may presume that only 5 per cent (£3·81 million) of their capital was invested in India.

In respect of banks, the share of Indian interests to the total cannot be said to be uniform. Of the 24 banking companies four, namely, the Chartered Bank of India, the Eastern Bank, the Mercantile Bank of India and the National Bank of India, have, probably, as much as 75 per cent (£10·39 million) of their aggregate capital and reserves employed in India, while in the case of the rest of the banking companies, the Indian part may not be more than 5 per cent (£4·12 million) of their capital and reserves. Companies classed under the head 'Navigation' number 18 with an average capital of somewhat under £2 million. It is possible, therefore, that they are mostly coastal and river navigation companies operating in the coastline of the Indian Empire and the neighbouring countries. We may assume that a minimum of 30 per cent (£10·65 million) of their capital would fall to the share of the Indian part of their business. In respect of 'Mining and Quarrying Companies other than Coal mining or Gold mining', of which there were 23 with an aggregate capital of £110·82 million, we may put down the Indian share to be 10 per cent (£11·08 million).

'Trading and Manufacturing Companies', too, may not be all mammoth concerns with ramifications round the world, though there may be some among them belonging to this category. Official statistics have given their number as 345 with an aggregate capital £344·37 million or an average of somewhat under £1 million per company. Since the industrial and commercial capital invested in India (excluding railways and public utilities) coming within the cognizance of British stock exchange intelligence was no more than £91 million (Sir Robert Kindersley's estimate for 1935), it would seem that only a fraction of these companies was large and respectable enough for their securities being quoted on the

British stock exchange. We may conclude, therefore, that the great majority of them are but small or medium in size. May be they are no more than Empire concerns at best. Even in respect of the large units among them, as Sir Robert Kindersley's annual surveys have shown, the tendency, during the inter-war years, had been to increase the share of their business within the Empire at the expense of that without. The average proportion of their Indian business may, therefore, be appreciable. We may put it at 25 per cent (£86·09 million). The aggregate amount of the capital under the fourth head of our classification would, then, amount to £126·14 million.

With regard to classification (5), the British and foreign participation in rupee companies, we have no information of any sort to go by. But it is generally believed that such participation, either by acquiring the shares of existing Indian enterprises,[22] by establishing fresh companies in combination with Indian capital or by floating subsidiary companies with the words '(India) Limited' tacked on to the names of the parent European companies, is considerable. Mr. G. D. Birla estimated the amount of such capital to be £100 million for the year 1929 and the *Financial Times* put it at £75 million for the year 1930.[23] In the absence of any other data to guide us we may take an average of these two estimates (£87·50 million), for what it may be worth, as holding true of 1939. This may not be an over-estimate because since 1930-31, the paid-up capital of joint-stock companies registered in India had risen from Rs. 257·90 crores (£193·43 million) to Rs. 290·90 crores (£217·79 million) in 1939.

Passing on to item (6) of our classification, we find that, in 1917-18, the last year for which the foreign ownership of the rupee part of the public debt of India was separately shown, out of a total of Rs. 202·15 crores of rupee loans, as

22. In 1928 and 1929 the Electric Bond and Share Co. of America, for instance, 'obtained a 50 per cent share in Tata and Sons, Ltd., a company controlling the electric power supply in Bombay'. See *Economic Journal*, June 1930, p. 177.

23. *Economic Journal*, March 1933, p. 170.

much as Rs. 100·42 crores (£66·95 million[24]) or about 49·5 per cent was held by foreigners. Since then the proportion of the loans owned by Indians has, doubtless, improved as a result of the steady increase in the preference of the savers for investments rather than for hoarding. In 1929, Mr. Birla believed that out of a total of £413·40 million (551·21 crores) of the rupee debt only £150 million or 36·3 per cent was owned by foreigners. Even assuming this percentage in 1939 to have been as low as 25, the foreigners' share of the rupee debt of India (Rs. 437·87 crores or £328·41 million) may be reckoned to be £82·10 million. I am inclined to regard this to be an underestimate, in as much as, the average yield on rupee loans being somewhat higher than that on British Government loans and the security of the former being almost as good as the latter, there is no reason to suppose that the interest of the British investors in the rupee debt of the Government of India has declined materially. We may, however, retain this figure if only to err on the safer side.

The last item, that is, foreign capital in private partnerships, firms, lands and buildings, is not the least difficult of evaluation. There are no pointers of any kind to help us. Existing estimates of the amount differ widely. For the year 1929 Mr. Findlay Shirras put it at £19 million,[25] while Mr. Birla thought it to be £140 million.[26] Mr. Findlay Shirras' figure is not the result of any careful investigation. It has no greater sanctity behind it than that it helped the author to raise the figure of the overseas investments in India from £481 million to the round figure of £500 million. Mr. Birla's estimate, on the other hand, is no more than a guess though bassed on day-to-day contact with business. No other exit from the difficulty being available, we can do no better than presume the amount under this head to be somewhere between these two figures; we may put it down at £100 million.

24. At 1s. 4d. per rupee.

25. *Economic Journal*, December 1932, p. 573 and September 1933, p. 533.

26. *Economic Journal*, September 1932, p. 485.

Our estimates of foreign capital in India in 1939 under the several heads of classification are, then, as under:—

TABLE XIII

An Estimate of Foreign Capital in India in 1939

Description	(£ million)
1. Sterling liabilities of Government of India ..	351·81
2. Capital of Joint Stock Companies registered elsewhere than in India but working principally in British India ..	73·57
3. Municipal and Port Trust borrowings ..	8·67
4. Capital of Joint Stock Enterprises with only part of their business in India ..	126·14
5. Capital of rupee companies registered in India ..	87·50
6. Investments in rupee securities ..	82·10
7. Investments in partnerships, firms, buildings and landed properties ..	100·00
Total ..	829·79

The above total, it will be noted, does not include, except in the case of banks, loan capital and reserve fund of joint-stock companies under heads (4) and (5). On the other hand, we have not taken into account, the foreign assets held by Indians and the Indian share of the Government's sterling loans. The aggregate of the latter two amounts would be, probably, smaller than the foreigners' claims over the loan capital and reserves of companies. We would be, therefore, only erring on the side of under-estimation if we set the omission on the credit side of the balance sheet against the omission on the debit side and regard £829.79 million[26a] as

26a. Since writing the above I have come across two other estimates of British capital in India, one by the *Statist* for the year 1939 and the other by the Associated Chamber of Commerce of India and Ceylon, which represents the British (capitalist) interests in this country, for the year 1931. Both are strikingly close to our own estimate. The *Statist*, after a private investigation extending 'over a period of some six months', in which it had the assistance of 'bankers, merchants, officials—great and small' and also of 'the various Chambers of Commerce which look after Indian trade concerns', arrived at a figure of

representing the net long-term indebtedness (nominal value) of the Indian economy to the outside world in the year 1939.

IX. The 1939 Indebtedness at March 1945 Prices

To arrive at the present value of this indebtedness the nominal amount of the debt would have to be amended in four respects. First, from it must be deducted the amount of the sterling debt repatriated since 1939. Second, we must ascertain the money value of the balance by reference to the dividend or the interest-income earned on it. Third, this value must be adjusted to the changes in the purchasing power of money as revealed by the index number of prices. Finally to it must be added the amount of the war-time increase in the rupee debt acquired by foreigners.

Since 1939 the volume of India's sterling obligations has fallen from Rs. 469·12 crores to Rs. 67.50 crores[27] in March 1945 or by Rs. 401·62 crores (£301·22 million). The nominal value of the external debt of the country, therefore, would be £528·57 million. If, following Mr. Findlay Shirras,[28] we may assume the average return on the overseas investments in India to be 5½ per cent—since the virtual cancellation of the sterling debt of the Government the average rate must be really more than before—and if we may further assume the long-term rate of interest ruling in the capital market to be 3½ per cent, the money value of the external debt of the country, at pre-war prices, would be £830·61 million. Since 1939, taking the General Index of Wholesale Prices compiled in the office of the Economic Adviser to the Government of India for our guide, the level of prices in India and, therefore, the money value of capital assets in general, may be said to have risen from a base of 100 in August 1939 to 247·8 in

£1,100—£1,200 million (2 September 1939, p. 282). And the journal emphasizes that it did not think this an exaggerated amount.

The estimate of the Associated Chamber, which was given in their evidence before the Simon Commission on constitutional reforms, was that it was 'not less than £1,000 million'.

27. *Budget for 1944-45*, p. 122.

March 1945.[28a] Making allowance for this rise the value of the foreign debt of India in March 1945 would be about £2,058·26 million.

28a. Since the use, in this case, of the general index, in preference to the security index, has been objected to (See *The Eastern Economist*, 23 November 1945, p. 750) and, at first sight, quite justifiably, we may give below our reasons for doing so:—

1. The amount of the foreign capital in India includes, besides that represented by securities quoted on the stock exchange, securities which are not so quoted and also capital in partnerships, firms, properties, etc., none of which is expressed in securities. In their case the general index would reflect the current value of capital better than the security index.

2. The Economic Adviser's security index comprises many quotations which are not sufficiently sensitive in responding to changes in market sentiment so that the index may, to that extent, be said to under-state the position.

3. Our estimate has taken notice of only the share capital of companies, omiting the important item of reserves, which, in the case of the larger and the older companies, at least, is often equal to or more than the amount of the share capital. To this must be added the undeclared hidden reserves. Through strengthening the financial position, or through improving the productive efficiency, of the enterprise (which would be the case if, as is more usual, the reserves are invested in the undertaking itself), the presence of the reserves would, no doubt, improve the value of the securities concerned; but this would not always be sufficient to raise the value of the capital to the full extent of the reserves. If so the security index would not reflect the correct market value of the entire amount of the foreign capital in India including share capital as well as reserves.

4. A practical test confirms the appropriateness of the use of the general index as a truer measure of the market value of foreign capital in India. It will be seen that when the pre-war *face value* of the capital of companies (taking a sufficiently large number of samples) is compared with their *market value* in March 1945, the latter is even a larger multiple of the former than our estimate of the *market value* of foreign capital is to its pre-war *face vlaue.* If so, the use of the general index cannot be said to produce an exaggerated impression. Indeed, the practical test only confirms my view that the figure I have given understates the case rather than the opposite.

To this figure must be added the amount of the rupee part of the public debt owned by foreign nationals from out of the issues made since March 1939. The volume of the rupee loans rose from Rs. 437·87 crores in March 1939 to Rs. 1,303·94 crores in March 1945[29] or by Rs. 866·07 crores. On the assumption, made above, that about 25 per cent of the rupee loans are held on foreign account, the foreigner's share of the increased issue would come to Rs. 216·52 crores (£162·39 million). This would raise the external debt of the country to a grand total of £2,274·78 million at March 1945 prices.

X. Is India To-day a Creditor Country?

We are now in a position to examine the claim that India to-day is a creditor country. With an external debt of so large a magnitude and with nothing to show on the credit side of the account in the field of long-term investments,[30] such a claim is, clearly, without any foundation of fact. The only item on the credit side is the sterling assets of the Reserve Bank which, on 30 March 1945, amounted to £1,022·54 million (Rs. 1,363·38 crores). Even assuming that the full amount of these assets would be available for extinguishing the foreign debt of the country, India would still remain a debtor to the extent of £1,252·24 million.

5. Finally, the index of industrial securities with variable yield, which among the security indexes would come nearest to our requirements, is quite unsatisfactory in as much as it does not cover the whole range of foreign capital in India; it may not do full justice to the appreciation in the capital invested in trade, tea and other estates, mines, banks, insurance companies, transport and such other non-industrial enterprises.

At all events, even the use of the security index would not upset our main thesis. For, in March 1945, the index number of industrial securities with variable yield was 202·9 (August 1939=100), while the general index number for the same date was 247·8.

29. *Budget for 1944-45*, p. 122; the figure for March 1945 represents budget estimates.

30. It will be noted that allowance has been made in our estimate to the foreign investments of Indian nationals. See p. 67 above.

It would be wrong, however, to imagine that the full amount of the sterling assets would be available for this purpose. Since they constitute the reserves held as security against the currency and deposit liabilities of the Bank, part of them would have to remain always with it under terms of the law. And, even supposing that the surplus was 'blocked' and was prevented from being converted into consumer goods, it is doubtful whether any portion of the assets will be left over after meeting other demands, which may prove to be more pressing, for liquidating the debtor status of the country. For, so long as the national economy was comparatively undeveloped and the rate of interest at home remained sufficiently above the rate of interest abroad, once the war-time restrictions on enterprise have been removed, it is exceedingly improbable that savers in general may seek foreign assets or foreign held domestic assets in preference to new investments within the country. If so the tendency would be to convert Reserve Bank sterling into investment goods for furthering programmes of internal economic expansion rather than for redeeming the indebtedness of the country. It may be noted that the authors of the Bombay Plan not only contemplate appropriating the entire amount of the sterling in the possession of the Bank but, considering this to be insufficient, propose, in addition, to raise loans abroad for financing their plan.[31] It would seem futile, therefore, to attempt to set the sterling reserves of the Bank against the long-term debts of the country.

If some writers have arrived at the opposite conclusion that India, at the present moment, is a creditor country, they have done so by allowing themselves to be misled by a very strange arithmetic. They have set against the sterling assets of the Reserve Bank some estimate of the pre-war magnitude of the foreign debt of the country (*less* the amount of the repatriated sterling debt of the Government) the latter being expressed at its *nominal* value.[32] Making use of our estimate of India's indebtedness, their argument, for instance, would

31. B. R. Shenoy, *The Bombay Plan*, 1944, p. 16.
32. *The Economist*, 3 June 1944, p. 754.

amount to saying that India today is a creditor by £493·97 million (£1,022·54 million *less* £528·57 million) since that is the amount by which the (commercial and industrial) external debt of the country at *pre-war prices* fell short of the sterling assets of the Reserve Bank as on 30 March 1945! But this procedure is, clearly, fallacious, among other reasons, because the money value of Indian investments in 1945 would be a multiple of their money value in 1939. And we have seen that, when due allowance is made for this and also for certain other factors, the 1945 value of India's external debt, in fact, exceeded by a very large sum, instead of the reverse, the magnitude of the sterling assets.

XI. The Pololand Parable

Indeed, arguing on first principles alone, theoretical possibilities on hypothetical assumptions apart, it is easy to establish the practical impossibility of a debtor country, *with a magnitude of indebtedness on the Indian scale in the Indian setting,* being converted into a creditor through the device of currency expansion. Let us suppose the indebtedness of a country, Pololand, to be $4x$ million dollars before the commencement of inflation, which let us further suppose, may be done through offering dollars to its central bank. Each time fresh polos, the currency of Pololand, were put into circulation, the polo value of goods, including foreign investments in Pololand, will increase. And, to bring the situation in a line with that prevailing in India to-day, if we may assume that the polo-dollar exchange rate was fixed, as inflation in Pololand progressed the dollar value of the foreign investments in the country will increase also.[33] If the polos in circulation were

33. It must be noted that the successful maintenance of the fixed exchange rate of the rupee, under conditions of a relatively higher rate of inflation in India than in Great Britain, is almost wholly due to the war-time controls on international trade. The argument in the hypothetical case we are now considering assumes the presence of similar conditions.

doubled, from x million to $2x$ million, the polo price-level will tend to be double too and the value of foreign investments will jump up towards $8x$ million dollars. As against this, assuming for simplicity's sake that one polo was equal to one dollar, the central bank of Pololand will have only x million dollars (*plus* the reserves of the pre-inflation period) in its reserves, which will be quite insufficient to extinguish external debt.

However much inflation may progress, the dollars received, in exchange for the polos issued, will be unable to catch up the rising value of foreign investments. And, as soon as the economy was no longer able to absorb fresh issues of currency, prices will begin to move faster than the pace of currency expansion. When this happened, to a given increase in the dollar assets of the central bank, the money value of the investments will increase by a larger multiple than hitherto and the dollar resources of the country, though their volume might be growing, would represent a falling proportion of the value of the foreign debt.

The position would be, no doubt, different from the above if the foreign debt comprised only fixed-interest-bearing securities. Their dollar-value may not, then, rise with the progress of inflation and the consequent rise in prices. It may, on the other hand, fall with the fall in the value of money, in which case a point may be reached at which the dollar resources of the country might prove sufficient to cancel its debts. But the foreign debt of India, at present outstanding, being, in the main, in the form of equities this possibility would not apply to the Indian situation.

The foregoing discussion, it will be noted, amounts to no more than a substantiation of the simple and ancient truth that inflation is no short-cut to economic prosperity. Reflation and the needs of certain types of progressive economies apart, exansionary creation of money is an un-mixed evil. But it is strange that some economists in this country should fail to pay sufficient attention to this doctrine and should prefer instead to get lost in a false and a wholly misleading arithmetic of numbers.

CHAPTER IV

THE STERLING ASSETS AND THE UNITED NATIONS' RUPEE EXPENDITURE

I. Six Possible Methods of Finance

Theoretically, Imperial and Allied war expenditure in India could be met through one or more of six several ways. It could be met, in the first place, by exporting to India goods for sale against rupees in the Indian market, the proceeds being utilized for payment of the bills arising out of such expenditure. The same result can also be attained by not taking from India goods, which, in the ordinary course, were destined to be exported to the United Kingdom or to one of the Allied countries in payment of imports, visible or invisible, the goods concerned being disposed of in India and their rupee value being credited to the account of the United Nations. Secondly, rupees to pay the war bills with could be collected by the import and sale of gold. In the third place, the Imperial Government could commandeer for disposal in India British owned Indian investments of which, as we have seen in the last chapter, there exist a vast volume of varied description. Fourthly, loans could be issued in India by, or on behalf of, the United Nations. In the fifth place, Great Britain may ask for the payment of Home Charges and other sterling obligations of the Government of India in rupees instead of in sterling. Finally, the Reserve Bank of India could be directed to issue to the Indian agents of the Imperial Government rupees against British treasury bills, or other *ad hoc* sterling paper presented to its credit at the Bank of England. We shall examine in some detail to what extent these several alternatives have been actually tapped.

II. Finance Through Imports

A policy of financing Imperial expenditure through the first device, if adopted, would register either an increase in the volume of imports or a decrease in the volume of exports

or partly the one and partly the other according as the goods sold in the Indian market were imported into the country or were made available through the United Nations deciding to keep in India goods meant for export to them. In the latter case payment to British nationals, equivalent to the value of the goods withheld from being exported, would be made by the British Treasury. In this manner it would obtain rupees in India in exchange for sterling of like value in Great Britain. The net result of either of the alternatives, however, would be the same. The volume of the favourable balance of trade of the country would diminish to the extent to which recourse was had to this method of finance, and, if it was pursued sufficiently far the habitual favourable balance may even get transformed into an unfavourable one.

Statistics of the foreign trade of the country, however, do not seem to provide any indication that this method of raising rupees had been, in fact, pressed into service. The value of the balance of trade, instead of falling, moved in the opposite direction as may be seen from the table below. It sprang up

Table XIV

Index Numbers of the Quantum of Imports and Exports and the value (in crores of rupees) of the Balance of Trade

(1938-39=100)

	1 Imports	2 Exports	3 Value of Balance of Trade (Crores of Rupees)
1938-39 ..	100	100	17·39
1939-40 ..	102·0	104·5	48·81
1940-41 ..	81·3	88·1	41·99
1941-42 ..	74·2	93·4	79·90
1942-43 ..	37·6	62·4	84·25
1943-44 ..	39·9	53·8	90·94

with a spurt in 1939-40, the year of the declaration of war, from Rs. 17·39 crores, the figure for 1938-39, to Rs. 48·81

crores. In the year 1940-41, however, it slightly declined to Rs. 41·99 crores. But in the following year it jumped up again to a record figure of Rs. 79·90 crores and, thereafter, steadily moved forwards, establishing new all-time records each year. In other words so far from goods being imported into the country to raise rupees with, the exact opposite was being done: goods were being exported on balance. India was serving as a supply base to the Allied Nations.

A study of the figures in the first two columns of the table above lends support to this conclusion. In view of the blockades and counter-blockades by the belligerents and also owing to the shortage of shipping space, a decline in the quantum of imports as well as of exports was, no doubt, only to be expected. But if recourse had been taken to the first method of finance, the diminution of imports would have lagged behind the diminution of exports and the gap between imports and exports would have shrunk in size. Actually, however, we notice that the index number of the quantum of imports fell faster than the index number of the quantum of exports. The former declined by 60·1 points as between 1938-39 and 1943-44 while the latter declined by only 46·2 points during the same interval. The British economy having been mobilized to capacity to cater to the needs of the Imperial war machine, it was not possible that any appreciable part of its resources could be diverted into producing goods for the Indian market.

This position, as revealed by published statistics, would remain unaffected by the direct importation of war materials by the United Nations either for use by their own armed forces in India or for presentation to the Government of India. The Finance Member in his budget speech for the year 1942-43, for instance, stated that roughly Rs. 60 crores worth of aeroplanes, vehicles, guns, and other equipment required in connexion with the expansion of India's Navy, Air Force and Army, was received or was expected to be received by the close of the year from His Majesty's Government free of charge.[1] But transactions such as these clearly

1. *Budget for 1942-43*, p. 11; also see *Budget for 1943-44*, p. 8.

fall outside the scope of our enquiry which seeks merely to ascertain whether, and to what extent, marketable goods were imported into the country, the sale proceeds of which were to be set against that part of the Imperial war effort which involved rupee expenditure. It has nothing to do with the manner of how the Government of India or the Allied Governments may provide themselves with the sinews of war which it may be beyond the prevailing capacity of the Indian economy to produce or which, for any other reason, they may decide to import on their own.

III. Finance Through the Sale of Lend-Lease Supplies

It is, however, different with the lend-lease stores and services received from America since 1942. Their value, whether sold to the public or used by the Government, was credited to U.S. account[2] and was cancelled against the cost of the reverse lend-lease aid given to the U. S. Government.[3] In effect, therefore, it was a case of goods being imported from America to pay for American purchases in India. Only the buying and the selling agents were the Government of India and the major part of the sales were made by the latter to itself, the quantities sold to the public being but negligible. Precise statistics of the lend-lease receipts by India, however, are not available. The Finance Member in his budget speech for 1944-45 observed that the principal difficulty in revealing the exact figures was that the allocation of the goods and services between the Governments of India and the United Kingdom had not yet been determined.[4]

2. See *Budget for 1942-43*, pp. 9 and 11; *Budget for 1943-44*, p. 12; and *Budget for 1944-45*, pp. 7 and 12.

3. Reciprocal aid was given in the shape of (i) rations, clothing, ordnance and other stores, construction of accommodation, airfields and connected works and provision of transportation, communications and maintenance facilities of various kinds; (ii) payments of port dues of all kinds on account of U.S. shipping using Indian ports, ship repairs, etc; and (iii) raw materials and foodstuffs such as tea required by the U.S. Government directly for war purposes. See *Budget for 1944-45*, p. 12.

4. *Budget for 1944-45*, p. 12.

But it was believed that the aggregate quantities received up to 31 March 1945 were valued roughly at Rs. 515 crores and India's share was assessed at approximately Rs. 150 crores.[5] Of this sum about Rs. 123·69 crores[6] were already drawn upon by way of reciprocal aid, which may be said to confirm our view that the U.S. lend-lease to India was only a device of financing part of the U.S. expenditure in India. We may, therefore, say that Rs. 123·69 crores of Allied expenditure in India was met in this manner.

IV. Sale of United Nations' Gold

In passing from the sale of merchandise to the sale of gold as a means of raising rupees for covering war expenditure in India, we come to a field of activities which remains enveloped in secrecy. Mr. T. T. Krishnamachari's interpellation in the Central Legislative Assembly in December 1943 regarding the sales of gold by the Reserve Bank, which had been engaging public attention for sometime, drew but a blank reply from the Finance Member. Mr. Krishnamachari had asked for information regarding the party on whose behalf the Bank had been selling gold, the amount of the profits made and whether India was given any share in the latter. Sir Jeremy Raisman, however, was of the view that to provide answers to the questions 'would be contrary to public interest'.[7] On 8 February 1944 the questions were repeated and Sir Jeremy allowed it to be known that the sales of gold, which, he said, had commenced on 17 August 1943, 'were made under arrangements between the Reserve Bank of India and the Bank of England on account of His Majesty's Government and the United States Government', adding that the gold 'was provided by those Governments from their own resources'.[8] In April 1944, in the course of

5. *Budget for 1945-46*, p. 5.

6. Made up as follows: Rs. 12·25 crores upto the end of 1942-43, Rs. 35·11 crores in 1943-44 and Rs. 76·33 crores (Revised Estimates) in 1944-45. *See Budget for 1944-45*, p. 12 and *Budget for 1945-46*, p. 5.

7. *Commerce*, 11 December 1943, p. 825.

8. *Commerce*, 12 February 1944, p. 231.

a debate on the subject in the Central Assembly and in the Council of State, the spokesmen of the Government stated that the entire amount of the profits on gold went to the selling countries.[9] In face of the reluctance of the Government to provide us with more precise information on the subject, we are, perforce, thrown back upon conjecture.

It would seem, however, that the sales of gold were prompted by three principal considerations, namely, the phenomenal profits which they brought, the need for a method of finance alternative to inflation and the relative advantages of gold over other commodities in the matter of transport, etc.

Profits from the sale of gold resulted from a combination of two circumstances. In the first place, unlike in the case of Great Britain and the United States of America[10]—countries which had gold to dispose of—in India the price of gold was not statutorily fixed but was left to be determined by free market forces. In the second place, the sterling value of the rupee was maintained at the statutory par of 18d. notwithstanding the fall in the purchasing power of the rupee relatively to that of sterling. As inflation progressed there ensued, therefore, a divorce between the price of gold in India and the price of gold abroad : the rupee price when converted into

9. The Honourable the Finance Member's objections to accepting a share in the profits on the sales of gold deserve notice. If anything of the kind was done, he observed, there would ensure a further accumulation of sterling, which was not viewed with favour in this country and which, he was, in any case, convinced, was capable of doing more harm than good. It was, therefore, in India's own interests that this benevolent trustee of our national finances was allowing Great Britain freely to make profit at our cost. Who knows his successor in office might produce a similar argument and distribute the sterling already accumulated among his countrymen, instead of on the basis of the sales of gold, may be on the basis of the sales of British manufactures, or pass it on to the British Treasury as a free gift, again, of course, in India's own interests! See *Commerce*, 22 April 1944, p. 617.

10. In the United States of America the price of gold was fixed at $35 a fine ounce long before the outbreak of war, whilst, in Great Britain, it was fixed at £8-8-0 on September 1939. The British price was raised to £8-12-3 with effect from 9 June 1945.

its sterling or dollar equivalent at the prevailing exchange rate was higher than the official prices in Great Britain and America. Marked disparity between the two prices had already made its appearance as early as November 1941[11] or even earlier. It increased with the acceleration in the pace of inflation as may be seen from the table below. If gold did not flow into the country earlier than August 1943 it was only because of the war-time restrictions on its movement. It

TABLE XV

Price of Gold in London and Bombay

	A			B			C			D		
	Price in London per fine ounce			Average price in Bombay per fine tola			London price converted into rupees per tola[12]			B-C		
	£	s.	d.	Rs.	a.	p.	Rs.	a.	p.	Rs.	a.	p.
1938-39	7	4	3	36	4	2	36	1	0	0	3	2
1939-40	7	18	4	39	14	7	39	9	4	0	5	3
1940-41	8	8	0	42	7	11	42	0	0	0	7	11
1941-42	Do.			44	10	10	Do.			2	10	10
1942-43	Do.			57	1	1	Do.			15	1	1
1943-44	Do.			76	11	6	Do.			34	11	6
1944-45	Do.			71	7	4	Do.			29	7	4

could cross national frontiers only under licence or on official account. And when the British and the U.S. Treasuries did decide to export gold to India, the profits to be derived were phenomenal. During 1943-44, judging from the lowest and the highest[13] prices touched during the year, they probably ranged between 66·66 per cent and 127·98 per cent.

11. The average price of gold in Bombay during November 1941 was Rs. 43-1-0 per fine tola when the British parity price was Rs. 42-0-0. See *Report on Currency and Finance*, 1941-42, p. 63.

12. Re. 1=18 d.

13. The highest and the lowest prices reached during 1943-44 were Rs. 95-12-0 (May) and Rs. 70 (March) respectively. See *Report on Currency and Finance*, 1943-44, p. 77.

And the sales policy of the Bank would seem to lend support to the view that profits were the primary consideration before the Allied Treasuries. It was not as if either they or the Bank were interested in keeping the Indian price of gold within certain limits with the aim, as such a line of argument might suggest, of the ultimate stabilization of the gold value of the rupee. The Bank was concerned solely with obtaining for its principals the best price that the market could offer. With this end in view it began by fixing its sale price by reference to the prevailing state of demand. Starting with a price at somewhat below Rs. 70 per tola in August 1943, following the market trend, the Bank raised its price to Rs. 76 in mid-December of the same year. The price was lowered with the reaction, which followed, and in the last week of January 1944 the Bank's selling price stood at Rs. 71. At this point, rather than follow the market further downwards, the Bank suspended its sales, stepping in only when prices recovered. Towards the close of March the price was raised again to Rs. 72.

From 29 March onwards, instead of fixing its own price, the Bank adopted the practice of inviting tenders, parting with its gold to the highest bidders. During April and May it was able to get in this manner Rs. 75-4-0 per tola. From 24 May to mid-August, when the market was quiet, sales were once more suspended and, until the first week of October, were resorted to only intermittently with the hope, it would seem, of getting better value for its gold. But, owing to the continued successes of the Allies, the price failed to recover. It was only when this was clear beyond doubt that the Bank showed its willingness to part with gold at about Rs. 70-8-0. Thereafter, it has been making sales in quantities varying between 25,000 tolas to 75,000 tolas per day almost without break at prices ranging between Rs. 62 and Rs. 75-6-0.

The urge for raising rupees through non-inflationary methods arose from the fact that the printing press had been set working at a ruthless pace and, as may be seen from the table below, prices had been jumping up, as a consequence, with alarming speed. Reserve Bank money, comprising notes and deposits, had multiplied 3·83 times as between August 1939 and August 1943 and the general index of whole-sale

TABLE XVI

Index Numbers of Inflation and Prices in India

(August 1939=100)

	A Notes in Circulation	B Reserve Bank Deposits	C A + B	D Primary Commodities	E Manufactured Articles	F General Index
Aug. 1939 ..	100	100	100	100	100	100
1939–40 ..	116·95	76·41	109·12	124·3	131·9	126·0
1940–41 ..	134·94	131·16	134·21	113·5	120·4	114·9
1941–42 ..	171·90	138·33	165·49	132·5	154·4	136·8
1942–43 ..	287·01	190·96	268·46	166·5	190·6	171·4
Aug. 1943 ..	422·12	225·53	383·43	235·3	251·8	238·0
1943–44 ..	434·44	265·84	401·88	233·4	251·8	237·3
1944–45 ..	541·34	658·14	563·97	240·5	258·3	244·2

prices had risen from 100 to 238 during the same interval. It was, therefore, probably thought that if created money was alone relied upon to raise rupees, prices might soon get out of control. And if this happened inflationary finance would have to assume galloping proportions, that is, to gain control over a given quantity of real resources progressively increasing volumes of money would have to be issued into circulation; and this would be the beginning of the collapse of the currency system. Recourse to the sale of gold was perhaps an indication of the desire on the part of the authorities to avoid too great a dependence upon inflation.[14]

It was also believed that the sales of gold would induce cultivators up-country to part with their hoards of grain and other produce of which there was now an acute shortage. The Foodgrains Policy Committee, for instance, had recommended that 'though it would be preferable to supply the cultivator with the goods he needs......yet if the supply of these cannot be increased adequately, it would be advisable for Government to secure supplies of the precious metals for sale to the cultivator'[15] as he may not be willing readily to exchange his stocks for currency. That this may have formed part of the policy behind the sales of gold was evidenced by the fact that, bars of 1,000 tolas being far beyond the capacity of the farmers, circular pieces of one and five tolas bearing the stamp of the Bombay Mint were created to meet his requirements. They were sold, at a premium of as. 4 and as. 2 respectively, from the middle of February 1944, for some time at all the offices of the Reserve Bank and also certain offices of the Imperial Bank of India,[16] but now only at the head office of the Reserve Bank in Bombay.

The relative advantages of gold over other commodities were principally that its demand on shipping space was

14. With the same end in view sales of gold were effected also in Egypt, Palestine, Syria, Lebanon, Saudi Arabia, Iran and China, where, too, inflationary finance had given rise to similar problems. See *Monthly Bulletin of Statistics*, Federal Reserve Board, December 1944.

15. *Commerce*, 25 September 1943, p. 470.

16. Agra, Amritsar, Benares, Lucknow, Lyallpur, Multan and Patna. See *Commerce*, 11 March 1944, p. 377.

insignificant when compared to the demand of merchandise in general. Moreover, unlike most of the latter, it is easily capable of being transported by air. Furthermore, since a year before the war it had been the policy of the British Treasury to disperse its gold stocks and gold acquired by the Exchange Equalization Account in India, Australia and South Africa had been left in these respective countries.[17] The problem of their transport to the Indian market was, therefore, far less taxing than the problem of bringing merchandise from Great Britain. These were merits of decisive weight in a situation of growingly acute shortage of shipping.

On the question of the amount of the sales of gold, we have nothing more substantial to go by than the daily and the weekly reports of the Press correspondents at the Bombay Bullion Exchange. We give below an estimate,[18] for what it may be worth, based upon their weekly reports published in the *Commerce* :—

TABLE XVII

Estimated Sales of Gold by the Reserve Bank

	Lakhs of tolas	Average price per tola in Rupees	Value in crores of rupees
1943-44[19] ..	87·95	76 11 6	67·48
1944-45[20] ..	100·56	71 7 4	71·86
Total ..	188·51	—	139·34

17. *Commerce*, 14 December 1940, p. 601.

18. The existing estimates of the amount are not up to date. *The Economist* believed that for the first six months, following August 1943, the quantity sold was 50 lakhs of tolas (See *Commerce*, 12 February 1944, p. 203). Our estimate took us to a figure of 44·11 lakhs for the same period. A writer in the *Commerce* (23 December 1944, p. 759) was of the view that the sales for the year 1944 were worth about Rs. 75 crores. Our calculations, however, were that the amount was about Rs. 105 crores (147·30 lakhs of tolas).

19. From 17 August 1943, when the sales of gold began, to 31 March 1944.

20. 1 April 1944 to 31 March 1945.

V. Finance Through Repatriation

Coming to the third of the theoretically possible methods of raising rupees, we find that the Imperial Government did not resort to it directly. It did not, that is to say, commandeer or otherwise acquire securities representing British investments in India for disposal in the Indian market against rupees, though it had done this, as we know, in respect of British, and also Indian, investments in America. The British Treasury had transferred to itself by compulsory vesting orders the American assets of residents in Great Britain whether expressed in sterling or dollars; Indian owned assets were taken over, dollar balances, in December 1940 and dollar securities, in March 1941, under Defence of India Rules 92 and 94. These were, then, disposed of in New York as and when dollars were required to pay for American purchases of essential supplies. Thus, in effect, overseas investments were exchanged for supplies, thereby reducing the creditor position of Great Britain and improving that of America.

Indirectly, however, something similar may be said to have, in fact, materialized in the case of the Indian expenditure as well, though through a somewhat circuitous and involved machinery. For, repatriation of the sterling debt of the Government of India, brought about during the war, amounted to (as we shall presently explain) a liquidation of British investments in India to meet an equal amount of the Indian bills of the Imperial Government. This becomes clear when we review the processes through which repatriation was effected. The Government of India, to begin with, met the 'recoverable' expenditure in rupees as it fell due from out of its general funds. Payment for this expenditure was received from the British Treasury in *ad hoc* sterling, against which rupees were obtained from the Reserve Bank. The sterling thus accumulating with the Bank was later utilized for acquiring the Government of India sterling debt, by purchase in the open market by a licence scheme issued in February 1940 and, subsequently, in February and December 1941, by the promulgation of compulsory vesting orders. It was utilized, too, for redeeming the sterling debt as it fell due, for funding

railway annuities, for purchasing railway debenture stocks, for buying private-owned railway companies, for liquidating India's share of the Chatfield debt and for a lump sum payment in final settlement of the non-effective charges owing to the British Treasury.

For the sterling acquired from the Bank payment was made in one or other of five several ways: (1) from out of the general funds of the Government; (ii) in rupee counterparts of the debts purchased and cancelled; (iii) in *ad hoc* Treasury bills; (iv) from out of the proceeds of Ways and Means Advances from the Bank; and (v) in one rupee coins and one rupee notes, the issue of which was a monopoly of the State. Subsequently, of the rupee counterparts passed on to the Bank, a portion, which was thought to be in excess of the absorptive capacity of the market, was cancelled against payment made from out of the cash balances of the Government, and some were issued to the public as and when the latter was able and willing to take them. Likewise the *ad hoc* Treasury bills were redeemed from out of the proceeds of the Defence Loans or other borrowings or were replaced by sterling which was subsequently received from the British Treasury.

The transactions outlined above, it will be noted, boil down to a simple case of exchanging British investments in India or other sterling obligations of the country for the supplies of goods and services provided by the Indian economy for the use of the Imperial Government. In substance they may be said to be analogous to the case of how Imperial expenditure in America, and also in certain other countries,[20a] was financed. For, though the British Treasury made payment, in the first instance, only in sterling, since the sterling so received was duly passed on to the holders of sterling debt, we may say that, in effect, payment was made in the sterling obligations of the Government of India.

20a. In 1938 the overseas assets of U.K., including investments, gold and foreign exchanges, were estimated to be about £5,000 million. Of this amount, by the end of 1943, £3,005 million was disinvested to finance war expenditure abroad principally America. See *The Eastern Economist*. 14 July 1944, p. 30.

VI. The Difference Between the Method Pursued in India and the Method Pursued in America

There exists, however, an important point of difference between the methods pursued in respect of the American expenditure and that followed in the case of the Indian expenditure. The entire burden of finding dollars in the one case rested on the shoulders of the British Treasury. The dollar securities were released by it in the U.S.A. through the machinery of the New York stock exchange. Neither the American Government nor the American monetary machanism had any direct hand in the process and the method of raising dollars was non-inflationary in character.[20b]

With regard to India, however, this may be said to have applied only to the extent (1) the rupee counterparts were taken up by the public, (2) the short-term advances raised from, or the treasury bills issued to, the Bank in connexion with the finance of repatriation were cancelled from out of the proceeds of Defence Loans or other borrowings from the public and (3) sterling purchased from the Bank was paid for from out of the cash balances of the Government[21] representing tax receipts. For, it would be in these cases alone that the inflationary money, which had been at first created against sterling, would be withdrawn from circulation and cancelled, the note and deposit liabilities of the Bank declining by the amount of the fall in its sterling assets. The rupee loans in the hands of the investing public in India (or in the possession of the State in the case of payments made from Governmental balances) would replace the sterling debts which, before the implementation of the repatriation scheme, had remained in the hands of residents in the United Kingdom.

20b. In 1941, however, to avoid forced sales of securities, dollar credits were granted to the British Treasury by the Reconstruction Finance Corporation against the collateral of dollar securities. See D. H. Heatherington, *Britain's Sterling Balances*, 1945, p. 9.

21. The same would also hold true of cases in which sterling acquired for repatriation was repaid in sterling freshly received from the British Treasury, if rupees provided against the latter were found by non-inflationary methods.

Though inflation had taken place at first it would be negatived by equivalent counter-inflation effected subsequently.

The same, however, would not hold true of the remaining methods of how sterling provided by the Reserve Bank was paid for. In their case there would not take place any cancellation of the rupee currency which had been created against sterling now passed on to the Government. Only sterling taken away from the assets side of the Banking and the Issue Departments would be replaced by an equal amount of assets of other description. They will be replaced by, that is to say, rupee counterparts, treasury bills of the Government of India, rupee coin and Ways and Means Advances,[22] according as which of the several methods was employed to acquire sterling from the Reserve Bank. The amounts appearing under these several heads, in other words, would move up by a margin equal to the decline in the sterling assets, so that the aggregate value of the assets (or liabilities) would remain the same before, as well as after, repatriation. This is equivalent to saying that the rupee finance, to this extent, was found through the expansionary creation of money, but not, in the case of the expenditure in the U.S.A., through mobilzing the voluntary savings of Indian people.

It would seem somewhat strange that this circuitous method of repatriation of the sterling debt should have been resorted to. For, we have seen, under it, the Reserve Bank first received sterling credits on behalf of the British Treasury from the Bank of England. They were, then, converted into sterling treasury bills, which, when it was time to purchase or redeem the sterling debt, were converted back again into sterling credits. In India, it involved the issue of an equivalent amount of rupee currency against sterling credits and, at the time of repatriation, their partial withdrawal and cancellation or the replacement of sterling on the assets side of the Bank by non-sterling assets. It involved, too, an amendment to the Reserve Bank of India Act, 1934, so as to enable the Bank to hold rupee securitties in excess

22. In the case of payments in 'rupee coin' or from out of the proceeds of Ways and Means Advances, the amounts appearing against 'Notes and Coin' and 'Loans and Advances to Governments' in the balace sheet of the Bank, will rise.

of Rs. 50 crores, the limit imposed by the proviso to section 33 (3). The amendment was essential as repatriation was not possible without passing on to the Bank substantial quantities of rupee counterparts and treasury bills.

It would have been vastly more simple for the British Government to acquire the sterling debt directly, in the manner it had acquired the dollar securities, and hand it over to the Government of India in settlement of the rupee expenditure incurred by the latter on its behalf. The Government of India might, then, have proceeded to find rupees against these sterling securities in more or less the same manner as had been done actually: it might have drawn upon its balances, raised Ways and Means Advances from the Reserve Bank and might have created the necessary rupee counterparts and *ad hoc* treasury bills: in the first instance the counterparts and the treasury bills might have been passed on to the Reserve Bank, against equivalent cash, pending disposal of the former to the public or the cancellation of both from the general funds of the Government or from the proceeds of loans. The final position might, then, have been exactly on a par with that actually reached through the more roundabout route: repatriation of the sterling debt would have been effected partly through the savings of the people (to the extent rupee finance was raised from the sale of counterparts, from the issue of loans or from the proceeds of taxation) but mainly through the inflationary creation of money.

VII. The Loss to the Indian Economy from the Indirect Method of Repatriation

The roundabout method actually pursued had, however, certain very definite merits from the British standpoint. In the first place, payment in sterling Treasury bills was, in the highest degree, effortless. It meant little more than some additional work to His Majesty's security printers. It was, moreover, well within the four corners of the currency law besides being simple and also highly expeditious. By comparison the issuing of vesting orders for the surrender of the British-owned Indian public debt, the fixing of their price, their collection, payment in sterling to their holders and their ultimate transfer to the Government of India were highly complicated and bothersome operations.

Secondly, nothing was to be lost by refusing to hasten with the process of repatriation.[23] On the contrary, as we shall presently see, postponement yielded to the British economy gain on interest as well as on capital account. On interest account the gain resulted from the fact that the holders of the sterling debt received payments at rates varying between 2½ per cent and 5 per cent, while, on the treasury bills issued in favour of the Government of India, payment was due from the British Treasury at not more than 1 per cent. Every delay in repatriation, therefore, brought to the British economy the benefit of the difference between the two rates. The table below gives an idea of the magnitude of the amounts realized in this manner :—

TABLE XVIII

Loss on Interest Account which entailed Delayed Repatriation
(Crores of Rupees)

		A	B	C	D
		Sterling Debt[24] Outstanding on 31 March	Interest Payments actually made	Amount of the Interest at one per cent per annum	B-C
1940-41	..	320·49	14·29	3·20	11·09
1941-42	..	186·31	9·51	1·86	7·65
1942-43	..	65·94	5·04	0·66	4·38
1943-44	..	46·61[25]	1·85[25]	0·47	1·38
1944-45	..	43·28[26]	1·73[26]	0·43	1·30
Total	..	—	32·42	6·62	25·80

23. On the assumption that the holders of the Government of India stock and of other sterling debt would be willing to invest the proceeds of their sale in treasury bills, the immediate liability to be incurred was only the interest payments due on the bills, whether it was the direct or the indirect method of repatriation which was resorted to. If, however, the holders of the debt should decide to convert the proceeds into long-term loans, the cost of the direct method of repatriation would be higher, than that of the indirect method, by the amount of the difference in the cost of short-and long-term borrowing for the period of the delay in repatriation.

24. Loans plus Capital portion of Railway Annuities created in purchase of Railways.

25. Revised Estimates.

26. Budget Estimates.

Figures in column B of the table represent interest payments made by India to the British Government, while figures in column C indicate the interest on British Treasury bills of a value equal to the unredeemed sterling debt. Though with the progress of repatriation the difference between the two magnitudes naturally diminished, for the five years of war, it totalled up to an impressive figure of Rs. 25·80 crores (column D).

Profits on capital account resulted from the fact that, owing to the normal channels of new investment having been blocked by war-time controls, sterling security prices were moving up in common with prices of old investments in general. Hurried repatriation would, therefore, have meant a denial to the British investor, and with him to the British economy, of the fruits of capital appreciation. The table on pp. 92-93 below gives an idea of the pace at which such appreciation was taking place.

It will be noted that, since the outbreak of war, the Government of India sterling stock, which had been on the decline for sometime, started turning upwards. India 2½% rose by £33, India 3½% by £21 and India 4½% by £7 as between September 1939 and their respective dates of cancellation. If these securities had been taken possession of even in, say, December 1940, when the dollar holdings of Indian residents had been compulsorily taken over, they would have cost to the Indian economy only £69, £94 and £109½ respectively. Actually their holders were paid somewhat over £78½, £100⅜ and £112 respectively[27] or at least £8½, £⅜ and £½ more per stock of £100 than their December 1940 prices. On the

27. Holders of stocks were paid the prevailing market price plus an allowance for the possible rise which might have taken place between the date of surrender and the date of their encashment. In respect of India 4½%, for instance, while the market price was £112 per stock of the face value of £100, the price paid was £112-17-0. See *Report on Currency and Finance*, 1940-41, p. 30.

TABLE XIX

Prices in London of the Government of India Sterling Securities[28]

Year	Date		A India 2½%	B India 3%	C India 3½%	D India 4½% '58–'68	E Remarks
1939	January 4	..	63½	75¾	89¾	115	
	Feruary 1	..	62	74½	88	113½	
	March 1	..	Do.	74¾	86¾	112½	
	June 7	..	Do.	74	86½	110	
	September 7	..	55½	66¼	79¾	105	
	October 4	..	Do.	Do.	79¼	Do.	
	November 8	..	58½	69[29]	81	104	
	December 6	..	59½	—	81½	104½	
1940	January 3	..	60	—	83	105	
	February 7	..	66	—	90½	111	
	March 6	..	70	—	95	114½	
	June 5	..	68	—	92½	111	
	December 3	..	69	—	94	109½	

1941	January 7	..	71	—	97	111½	
	February 4	..	Do.	—	96½	112[29]	Surrendered under the vesting order of 7 February 1941; purchase price, £112-17-0.
	February 11	..	74	—	98½	—	
	March 11	..	75	—	99	—	
	June 3	..	74¾	—	99¼	—	
	December 2	..	Do.	—	Do.	—	
	December 16	..	78½[29]	—	98¾	—	
1942	January 6	..	—	—	101¾	—	
	February 3	..	—	—	101⅞	—	
	March 3	..	—	—	101	—	
	June 2	..	—	—	100¾	—	
	September 8	..	—	—	100¾[29]	—	

28. No quotations are available for the remaining stocks. But the trend of their price fluctuations, the Finance Member tells us, was 'more or less parallel in the United Kingdom and in India'. *Budget for 1942-43*, p. 14.

29. No quotations after this date.

total amount of these three categories of loans outstanding, the profits of capital appreciation since 1940 were as under:—

TABLE XX

The Amount of Capital Appreciation of the Sterling Debt

Description of the Loan	Amount of the Loan Outstanding on 30 November 1940 (£ million)	Difference per £100 in the price as between December 1940 and the date of cancellation (£)	Total Capital Appreciation (£ million)
India 2½% ..	11·54	8½	0·98
India 3½% ..	87·32	6⅜	5·55
India 4½% ..	17·50	2½	0·43
Total ..	116·36	—	6·96

From the table we find that the gain to the Britishers from these *three classes of loans* alone was £6·96 million (Rs. 9·28 crores).

In the third place, the more roundabout method shifted the responsibility of collecting the stock, together with the attendant difficulties, on to the back of the Government of India. For, the necessity of Great Britain may be said to have passed as soon as rupees were issued against sterling Treasury bills. Once this had been done the British Government could hand over to India the sterling debt at its own convenience and could very well afford to choose the most suitable time for doing so, since the Government of India could not proceed with its programme of repatriation without the aid of British vesting orders. In other words it was well within the power of the British administrative machinery to delay compulsory acquisition of the securities, thereby interfering with the pace of the progress of repatriation such that the British investors realized the full measure of capital appreciation.

We have at least two concrete instances of the willingness of His Majesty's Government to exercise the privileges of this position of vantage, conferred upon it by the sterling exchange standard, for the benefit of the British holders of India's sterling debt. The Government of India was unable,

or so the Honourable the Finance Member, in effect, stated, to persuade the Imperial Government to issue the necessary vesting orders, under Defence Regulations, for the compulsury surrender of the $3\frac{1}{2}\%$ undated sterling stock[30] and the $3\frac{1}{2}$ per cent railway debenture stock.[31] They could be only redeemed at par after giving a year's notice in accordance with the terms of their issue. If vesting orders had been issued they might have been purchased at the then prevailing market price which was below par.

The roundabout method of cancelling the external indebtednes of the Government, in other words, proved to be an instrument for shifting economic well-being from India to Great Britain, from the peasant to the British bond-holders. And in so far as this aspect of the matter was concerned, it made no difference at all whether all this was foreseen or whether it was only a fortuitous gift of nature. But it must be noted that such a gift could not, by any chance, be made to accrue from out of the repatriation of the British investments in America. The dollar not having been linked to sterling, the method of payment by the simple device of offering sterling credits to the Federal Reserve Banks and inflating American currency against them was not open. The roundabout method of repatriation, in other words, remained blocked at the very initial step. Liquidation of the British investments in America had necessarily to be effected by the direct method. And since a rise in their prices, under the circumstances, would have to be paid for by the British Treasury, no time was lost, as we know, in taking them over from the residents in Great Britain as well as from those in the overseas Empire.

VIII. The Amount of the Finance Raised Through Repatriation

We shall now bring together, in the table below, the aggregate amount of the Imperial expenditure which was met through the repatriation of the sterling obligations of the Government of India :—

30. *Budget for 1942-43* p. 15.
31. *Budget for 1943-44,* p. 18.

TABLE

Repatriation of India's

Manner of Repatriation	Description of the Debt	1939-40	1940-41
1. Open market purchases.	(i) 3% 1948 or after. (ii) 3½% 1931 or after. (iii) Railway Debenture stock.[1]	17·09 (16·54)[2]	9·22 (8·52)
2. Licence scheme of 22 February 1941.	Six terminable stocks.[3]	— —	2·02 (2·02)
3. First compulsory scheme of 8 February 1941.	Do.	— —	60·05[4] (64·70)[5]
4. Second compulsory scheme of 24 December 1941.	Two non-terminable loans.[6]	—	—
5. One year's notice of redemption given on 25 December 1941.	3½% 1931 or after.	—	—
6. Notice of redemption given on 12 March 1943.	—	—	—
7. Funding agreement between the British Government and the Government of India (September 1942).	Railway Annuities.	—	—
8. Vesting orders of 19 February 1943.	Nine Railway Debenture Stock.[8]	—	—
9. Cash payment.	Chatfield Debt.[10]	—	—
10. Acquisition by purchase.[11]	M & S.M., and S.I.R.	—	—
11. Do.	B. N. R.	—	—
12. Capitalization by agreement between His Majesty's Government and the Government of India[13]	A portion of the non-effective charges.	—	—
Total.		17·09 (16·54)	71·29 (75·24)

XXI
Sterling Obligations (in £ sterling)

1941-42	1942-43	1943-44	1944-45	Total
12·11 (12·36)	10·48 (10·40)	1·60 (1·63)	—	50·50 (49·45)
—	—	—	—	2·02) (2·02)
13·08 (14·14)	1·45 (1·13)	0·16 (0·16)	0·09 (0·09)	74·83 (80·22)
73·85[7] (65·78)	5·22 (4·31)	0·32 (0·28)	0·25 (0·21)	79·64 (70·58)
—	56·21 (56·21)	0·71 (0·71)	0·03 (0·03)	56·95 (56·95)
—	—	8·80 (8·80)	—	8·80 (8·80)
—	27·06 (30·05)	—	—	27·06) (30·05)
—	18·58[9] (18·38)	1·33 (1·29)	0·04 (0·04)	19·95 (19·71)
—	—	8·50 (8·50)	—	8·50 (8·50)
—	—	—	6·35 (6·35)	6·35 (6.35)
—	—	—	3·65[12] (3·65)	3·65 (3·65)
—	—	—	15·00 (15·00)	15·00 (15·00)
99·04 (92·28)	119·00 (120·48)	21·42 (21·37)	25·41 (25·37)	353·25 (351·28)

IX. Repatriation Finance Raised Through the Inflationary and the Non-Inflationary Methods

From the table we see that, during the six years of war, Imperial expenditure to the extent of £350·91 million (Rs. 467·88 crores) was met by repatriating the sterling debt of the Government of India. It is not easy, however, to say how much of the repatriation finance was raised through inflation and how much was raised through the sale of rupee counterparts and other loans to the public. Since borrowing of both permanent and temporary nature had been resorted to by the Government to raise repatriation finance as well as finance for covering revenue deficits and capital expenditure, figures of the public debt in themselves would give us no idea. It would seem possible, however, to get at it indirectly.

Footnotes to Table XXI on pp. 96-97 above:—

1. These were bought only in 1942-43 and 1943-44.

2. Figures in brackets represent purchase value, the non-bracketted figures being face value.

3. (i) 3% 1949-52, (ii) 3½% 1954-59, (iii) 4% 1948-53, (iv) 4½% 1950-55, (v) 4½% 1958-68 and (vi) 5% 1942-47.

4. Of this amount £6·03 million was held in India.

5. Including the purchase price of the amount held in India which was redeemed mainly in rupee counterparts and partly in rupees.

6. (i) 2½% 1926 or after, (ii) 3% 1948 or after, the amounts outstanding being estimated at £11 million and £70 million respectively.

7. Of this amount £3·99 million was held in India.

8. (i) 5% Special B.N.W., (ii) 4% B.N.R., (iii) 3% Burma Railway, (iv) 4½% E.I.R. Irredeemable, (v) 3% E.I.R. New Debenture, (vi) 4% E.B.R. Irredeemable, (vii) 4% G.I.P. Irredeemable, (viii) 4½% S.I.R. Perpetual, (ix) 4% S.I.R. Registered.

9. Includes £0·58 million held in India.

10. ¼ of the pre-war capital cost of modernizing the Army in India (£34 million). See *Budget for 1943-44*, p. 11.

11. Effected on 1 April 1944, 21 months in advance of the date when we would be entitled to do so under the agreement with the Railway companies. See *Budget for 1944-45*, p. 17.

12. This figure has been derived as under: *The Report on Currency and Finance*, 1943-44, (p. 52) states the purchase price of M.S.M. and S.I.R., which were acquired on 1 April 1944, to be £6·35 million, while the *Budget for 1945-46* (p. 16) gives the cost of purchase of M.S.M., S.I.R. and B.N.R. to be £10 million. It follows that the cost of B.N.R. was £3·65 million.

13. *Budget for 1945-46*, p. 16.

TABLE XXII

Budget Deficits of the Government of India and Loan Funds

(*Crores of Rupees*)

	A	B	C	D	E	F
	Budget Deficit[1]	Increase in Rupee debt during the year	Net Railway Surplus on Capital Account[2]	Increase in Rupee Securities in the Issue Department during the year	Loan Funds raised through non-Inflationary Sources (B+C—D)	Surplus of E over A
1939-40 ..	4·00	17·83	1·58	6·05	13·36	9·36
1940-41 ..	11·15	133·38	8·60	49·53	92·45	81·30
1941-42 ..	12·84	79·83	15·30	48·38	46·75	33·91
1942-43 ..	166·33	267·45	8·82	38·21	238·06	71·73
Total ..	194·32	498·49	34·30	142·17	390·62	196·30

1. Revenue Deficit plus Capital Expenditure *excluding* Capital Expenditure on Railways which is covered by column C.

2. Appropriation to Capital from Railway Revenue *plus* Depreciation *less* Expenditure on Railways on Capital Account.

On the assumption that the rupee securities in the Issue Department of the Reserve Bank represented inflationary funds issued in favour of the Government, we may say that the non-inflationary moneys raised during a year for financing repatriation and budget deficits (column E, Table on p. 99 above) would be equal to the increase in rupee debt (column B) *plus* the net railway surplus on capital account (column C) and less the increase in the rupee securities in the Issue Department of the Bank (column D). And from column F, which gives figures of the difference between this amount and the budget deficit of the Government, we find that the loan funds throughout left a surplus after filling the gap (column A) between the Government's receipts and expenditure. We may assume, therefore, that this surplus was utilized for financing repatriation, the balance of the funds required being found through monetary expansion. On this reasoning repatriation finance may be said to have been collected through inflationary and non-inflationary methods as under[3] :—

TABLE XXIII

How Repatriation Finance was Raised

(Crores of Rupees)

		A	B	C	D	E
		Sterling Debt Repatriated	Repatriation Finance raised through the issue of Loans[4]	Repatriation Finance raised through Monetary Expansion	B as a percentage of A	C as a percentage of A
1939-40	..	22·05	9·36	12·69	42·53	57·47
1940-41	..	100·32	81·30	19·02	81·30	18·70
1941-42	..	123·04	33·91	89·13	27·56	72·44
1942-43	..	160·64	71·73	88·91	44·64	55·36
Total	..	406·05	196·30	209·75	48·34	51·66

3. Figures in column C, it will be noted, are at variance with the figures given by the Honourable the Finance Member in his budget speeches of 1942-43 (para. 47) and 1943-44 (para. 50). This is so because the Finance Member's figures relate only to 'central bank

The table indicates that, except during 1940-41, when 81·30 per cent of the funds represented the proceeds of loans, the greater part of the repatriation finance represented created money. Looking to the four years (from 1939-40 to 1942-43) as a whole, less than one half, 48·34 per cent, was raised through issuing loans to the public and the rest, 51·66 per cent, by adding to the monetary circulation.

X. The Issue of Loans by, or, on Behalf of, Great Britain

The fourth possible device of meeting the United Nations rupee expenditure, namely, floating a loan in the Indian capital market, may be at once dismissed, as no recourse at all was had to it. Theoretically, however, it would amount to the same thing if the proceeds of the loans issued by the Government of India were employed for financing the United Nations' Indian expenditure. The loan method might, then, be said to have been resorted to indirectly. But, actually, as may be seen from columns A and B of Table XXIII above, the loan funds fell short of the needs of the Government of India. Though some surplus did remain after meeting budget deficits, this was less than sufficient to meet the demands of repatriation. Nothing was, therefore, left over for meeting the disbursements on behalf of the British Treasury.

XI. Finance Through Home Charges and Inflation

There remains to consider the fifth and the sixth methods of raising rupee finance, that is, by asking for the sterling disbursements of the Government of India in rupees and through inviting the Reserve Bank to issue currency or credit

finance' raised for purposes of repatriation, while the figures in the table above relate to repatriation effected through monetary expansion. The latter includes, the former does not, the payments received from the Reserve Bank for one rupee notes and rupee coins issued to it by the Government.

4. Rupee counterparts and War Loans.

against *ad hoc* sterling. These need not, however, detain us long as we have already discussed them at some length in the first chapter. The table below gives figures of the moneys realized from the two methods since 1939 :—

TABLE XXIV

Rupee Finance raised through Home Charges and Inflation

(*Crores of Rupees*)

	Home Charges received in Rupees	Reserve Bank Money issued against Sterling	Total
1939-40	.. 27·07	70·06	97·13
1940-41	.. 30·48	2·50	32·98
1941-42	.. 33·28	103·65	136·93
1942-43	.. 48·97	260·91	309·88
1943-44	.. ?	437·01	437·01
1944-45	.. ?	417·32	417·32
Total	.. 139·80	1,291·45	1,431·25

XII. THE TOTAL RUPEE EXPENDITURE OF THE UNITED NATIONS

We may now bring together, in the table XXV, the amount of the rupee finance collected from the six several sources which we have examined above. The table reveals with striking plainness the extent to which each of these sources has been tapped. While repatriation, monetary expansion and Home Charges were drawn upon during all the six years, sales of gold were resorted to only since 1943-44 and U.S. lend-lease since a year earlier. Main reliance, however, was always placed upon the first two sources named above, principally the second, the amounts obtained from the sales of gold, lend-lease supplies and Home Charges being small in comparison. Looking at the

six years of war as a whole, of an aggregate expenditure of Rs. 2,162·14 crores as much as Rs. 1,291·45 crores or 59·73 per cent was met through inflating the Indian currency against sterling, Rs. 467·86 crores or 21·64 per cent by handing back the sterling debt of the Government of India, Rs. 139·34 crores or 6·44 per cent in gold, Rs. 139·80 crores or 6·47 per cent in Home Charges and Rs. 123·69 crores or 5·72 per cent in U.S. lend-lease goods. Looking at the several years individually it was only in 1940-41 that the largest part, 75·26 per cent, of the Allied expenditure was financed through repatriation. In the following year, too, the major portion of it, 47·33 per cent, was met in the same manner. But during the rest of the years the largest amount of the finance, varying between 54·05 per cent and 76·92 per cent, was raised through the device of inflation.

XIII. The Ratio Between the Finance Raised Through the Inflationary and the Non-Inflationary Methods

It will be noted, however, that in actual fact the amounts of the United Nations' rupee expenditure met through inflation were much larger than the above percentages might indicate. For, as we have seen, inflation was resorted to not only against sterling but also to provide part of the repatriation finance. But, since the purpose of both was payment of the United Nations' bills, we may say that the sum of the two, not merely the amount of the inflation against sterling, represented the amount of the rupee finance raised through the inflationary method, though it must be observed that inflation for repatriation resulted from the failure of the Indian public to take rupee counterparts of the sterling debt or equivalent Government bonds of other description. It cannot be described as inflation at the instance of Great Britain in the same way as inflation against sterling credits, since, in their case, the latter may be said to have made payment in the obligations of the Government of India, not in sterling credits. But this does not take away from the fact that the bills concerned were met in created money.

The rest of the rupee finance, namely, the credits against lend-lease supplies, the proceeds of the sales of gold, repatria-

TABLE

The United Nations' Rupee

(Crores

	1939-40		1940-41		1941-42	
	Amount	Percentage of Total	Amount	Percentage of Total	Amount	Percentage of Total
1. Lend-Lease Supplies received from U.S.A.[5]	—	—	—	—	—	—
2. Sale of United Nations' gold.	—	—	—	—	—	—
3. Repatriation of the Sterling Debt.	22·05	18·50	100·32	75·26	123·04	47·3[illegible]
4. Issue of Loans.	—	—	—	—	—	—
5. Home Charges.	27·07	22·71	30·48	22·87	33·28	12·80
6. Monetary Expansion against Sterling.	70·06	58·79	2·50	1·87	103·65	39·87
Total.	119·18	100	133·30	100	259·97	100

5. The figures entered against this head represent the amounts of the lend-lease credits, as the value of the latter was always in para. 14.

XXV

Expenditure and How it was Met

of Rupees)

1942-43		1943-44		1944-45		Total	
Amount	Percentage of Total	Amount	Percentage of Total	Amount	Percentage of Total	Amount	Percentage of Total
12·25	2·54	35·11	6·18	76·33	12·75	123·69	5·72
—	—	67·48	11·88	71·86	12·00	139·34	6·44
160·64	33·27	28·49	5·02	33·32	5·57	467·86	21·64
—	—	—	—	—	—	—	—
48·97	10·14	?	?	?	?	139·80	6·47
260·91	54·05	437·01	76·92	417·32	69·68	1,291·45	59·73
482·77	100	568·09	100	598·83	100	2,162·14	100

of the reciprocal aid given to the U.S. They were fully met from out excess of the value of the former. See *Budget Speech for 1945-46,*

TABLE XXVI

Rupee Finance to meet the United Nations' Expenditure raised through the Inflationary and the Non-Inflationary Methods[5a]

(*Crores of Rupees*)

	1939–40		1940–41		1941–42		1942–43		Total	
	Amount	Percentage of Total	Amount	Percentage of Total	Amount	Percentage of Total	Amount	Percentage of Total	Amount	Percentage of Total
1. Amount collected through non-inflationary methods ..	36·43	30·51	111·78	83·86	67·19	26·04	132·95	27·54	348·35	35·00
2. Amount collected through inflation ..	82·75	69·49	21·52	16·14	192·78	73·96	349·82	72·46	646·87	65·00
Total ..	119·18	100	133·30	100	259·97	100	482·77	100	995·22	100

5a. Based on the figures given in Tables XXIII and XXV.

tion funds raised through the issue of loans to the public and the amount of the Home Charges received in rupees, may be said to represent moneys collected through non-inflationary methods. On this reasoning for the first four years of war, for which alone full data on the subject is available at the time of writing, the amounts drawn from the inflationary and the non-inflationary sources would be as given in the table on p. 106 above.

A comparison between Tables XXV and XXVI shows that the extent of the dependence on inflation for meeting the United Nations' rupee expenditure, for the four years under review, never fell below 16·14 per cent and was as high as 73·96 per cent. The low water mark did not fall as low as 1·87 per cent nor was the high water mark only as high as 58·79 per cent (as one might be led to believe from Table XXV). And, during 1940-41, it was not as if only Rs. 2·50 crores were found through monetary expansion; the amount so found was, in fact, Rs. 21·52 crores. Looking to the four years as a whole, the dependence on inflationary and non-inflationary sources was respectively in the ratio of 65·00 per cent and 35·00 per cent.

CHAPTER V

HOW THE UNITED NATIONS' RUPEE EXPENDITURE MIGHT HAVE BEEN MET WITHOUT RECOURSE TO INFLATION

I. Introductory

Of the six methods of raising rupee finance for meeting the United Nations' Indian expenditure, which we have reviewed in the last chapter, the sixth, namely, inflating the Indian currency, was, as will be clear from what we have said on the subject in Chapter I, the simplest and also the most highly expeditious one. It was, moreover, the least expensive, the cost it involved being no larger than the cost of paper and printing plus the nominal interest payable on sterling treasury bills. Redemption of the bills at the due dates presented no difficulty whatever, since the maturing bills could be replaced, as in fact they have been, by fresh ones.

It did not call for a diversion of resources from essential production at home for the manufacture and shipping of British goods for the Indian market. Nor did it involve the sacrifices which would have entailed the disposal in India of the British owned investments in Indian trade and industry, as it would have further scaled down the volume of some of the most valuable overseas assets of the country. It did not demand, too, a depletion of the gold stocks of the Empire which needed to be conserved for the purchase of supplies from neutral sources. Furthermore, it was free from the uncertainties and the delay of floating a loan in India. Finally, as we have explained elsewhere, it proved to be a handy device for shifting a portion of the burden of the war from the British to the Indian people. The anxiety of the Imperial Treasury to draw upon this source to the maximum permissible extent, consistent only with the safety of the currency system, its unwillingness or reluctance to tap other sources, the restriction of repatriation to Government debt and resort to sales of gold only after inflation had assumed dangerous proportions, will, therefore, be easily appreciated.

From the standpoint of Indian interests, however, as we have explained at some length in Chapter II above, the inflationary method was by far the worst of the five. But it was certainly not inevitable that resort should have been had to it so freely and in so large a measure. The remaining alternatives might have been tapped to a much greater extent, especially those in which room for it existed, than had been done actually. This, however, presupposes political sovereignty and its accompaniment of unfettered freedom to adopt such measures as may be necessary to prevent too easy recourse being had to payments in sterling credits. For, in the absence of adequate pressure, the temptation on the part of the British Government to evade more irksome alternatives, which would add to the sacrifices imposed by the war upon the British citizen, and follow the line of least resistance under cover of the most handy argument of the exigencies of war, is likely to prove too strong, as, indeed, has actually happened.

II. Import of Capital Goods

On the essential hypothesis of a politically sovereign Government of India, a course of action, somewhat on the following lines was open and might have been pursued with profit. To begin with it was necessary to block the conduit pipe of inflation against sterling credits by delinking the rupee from sterling or by extending exchange control to sterling transactions if this was permissible consistently with a formal maintenance of the link.[1] We could, then, insist, in the first place, on payment to the utmost possible capacity in capital goods such as heavy machinery, machine tools and the like. This might have been done through the normal channels of trade or by a more intensive use of the principle of lend-lease or an extension of its application from

1. It is interesting to note that under the Government of India Act, 1935, the Indian Legislature is powerless, except with the approval of the Governor-General, to consider any changes in the Indian currency standard or to alter the sterling value of the rupee.

the United States of America, to which it remained restricted, also to the United Kingdom. The demand, on the part of the belligerents, for Indian supplies generally being more or less inelastic, insistence on payment for goods in goods was bound to produce results. If the overall surplus exports of the war years had been exchanged for goods in this manner, disbursal of the United Nations' expenditure might have been met, up to the end of 1944-45, to the extent of Rs. 562 crores (see column A, Table V on p. 18 above). Actually, however, as we have seen, the expenditure paid for in goods was only Rs. 123·69 crores.

In addition to preventing inflation to this extent, importation of capital goods would have enabled industrial advancement of the country even while the war was on. If they were made available in quantities equivalent to the surplus exports of the country, the rate of progress which they would have made possible may be gauged from the fact that the capital invested in industries in India in the pre-war period, excluding railways and other forms of transport, has been estimated to be only Rs. 700 crores.[2] Assisted by high prices at home and free from competition from foreign rivals, pre-occupied as they were with war production, the opportunities offered by the war would have enabled the country at least to lay the foundations of the more essential basic industries such as heavy engineering and heavy chemicals. Their absence has always been a great handicap to the progress of industrialization in peace as well as in war. It would also have been possible to advance in other directions as well, improving existing industries or establishing new ones. This would have enabled us the better to face the problems of economic development in the immediate post-war period when the capacity of the great powers, absorbed as they would be with their own problems of reconstruction at home, to come to our aid is not likely to be appreciably larger than during the war. At the same time it would have increased materially the war potential of the Indian economy even

2. See B. R. Shenoy, *The Bombay Plan*, 1944, p. 5.

while the war was being fought by adding to its capacity for industrial production.

In actual fact, however, Indian industries, depending as they do upon imported machinery and other capital equipment, have been virtually starved of these supplies during the past several years so that the productive plant of the country at the present moment is in a badly worn condition. It has been, or is being, worked to exhaustion, with the attendant decline in its productive efficiency or man-hour-production. Though this would be undoubtedly true also of other belligerent countries, they may not have suffered to the extent of this country, as, with the exception of China, nearly all of them are more or less well equipped with their own instrumental industries and are, consequently, better able to attend to the maintenance of capital.

III. Repatriation of Industrial and Commercial Investment

Another non-inflationary method of finance which might have been tapped with advantage was the repatriation of India's industrial and commercial debt held abroad. The aggregate amount of it, at pre-war prices, was, as we have seen elsewhere, £477·98 million[3] or Rs. 637·32 crores. No part of it was acquired by the British Treasury for setting against Imperial expenditure in India, though there, undoubtedly, was some room for doing so. The price of foreign investments in India, like that of equities in general, was on the ascendant. This, coupled with the fact that facilities for new investments, owing to war-time controls, were well nigh non-existent, might have sufficiently raised the demand price for them, notwithstanding the divergence in the long-term *real rate* of interest in India and Great Britain. Furthermore, foreign capital in India was mostly in enterprises and trades which are much favoured by the investing public. It was possible, therefore, that they would have been eagerly taken up by the latter in exchange for

3. Excluding the sterling liabilities of the Government of India of a value of £351·81 million. See Chapter III, p. 67.

their savings.[4] In particular the shares of exchange banks, of the coal mines, jute mills, iron and steel factories, the cotton textile mills, the better-known trading firms and the municipal and port trust borrowings may have had a ready market.

It is difficult to estimate, however, what part of rupee finance might have been raised in this manner. But on the assumption of one third the total volume of foreign capital being employed for the purpose, it would amount to Rs. 196·03 crores. Actually, as we have reviewed above, finance through repatriation was restricted to Government debt, the amount raised through the sale of counterparts or other rupee loans, that is, through non-inflationary methods, being, up to the close of the year 1942-43, Rs. 196·30 crores.[5] Since the balance (Rs. 209·75 crores) of the debt repatriated was financed only through inflation, it would seem that the rupee loans which replaced the debt had been absorbed to saturation point by the investing public in the country. Rather than insist upon further repatriation of Government debt beyond this limit, it might have been more expedient to tap the voluntary savings of the people by offering them the commercial and the industrial debt the possibilities in the demand for which had been left untouched.

IV. Issue of Sterling and Dollar Loans

The third non-inflationary method to which no attention at all was paid was the issue of loans in India on behalf of the United Nations. They might have been placed in sterling or in dollars or even in rupees on terms attractive enough to the Indian investor. If in the initial stages of the war, when the Allies were suffering reverses and the question of victory was still in doubt, the chances of a successful issue were considered meagre, with the turn of the tide against the enemy the necessary favourable background may be said to have been created. And, if the loans were made payable at dates roughly

4. Also see pp. 133-34 below.
5. See Chapter IV, p. 100 above.

corresponding to the time when the entrepreneurs would need funds abroad to finance their schemes of post-war reconstruction and expansion, they might have found favour with certain classes of investors. They might have also helped to solve the problem of the possible scarcity of exchange resources in the immediate post-war period, as subscription to the loans would, then, simultaneously amount to building up, for future use, equivalent supplies of foreign exchanges. By reducing to that extent, the pressure of the demand on the currently accruing exchange credits, this policy might have, in addition, contributed to exchange stability after the war. Furthermore, even as the issue of Government loans helps to develop the investment habit in communities in which capital tends to remain accumulated in hoards, the policy of placing on the market sterling and dollar loans on behalf of Allied Governments, apart from providing rupees to meet their expenditure with, might have initiated the Indian investing public into the habit of foreign lending.

V. Sale of Gold

Finally recourse might have been had to sales of gold on a larger scale than actually, though it must be admitted that to exchange goods for a dead asset such as gold would ill conform to an enlightened economic policy. Following the precedent of Sweden, in both the present and the last world war, one should much rather put an embargo on the imports of gold, in order to prevent private preferences of individuals for the metal from prevailing over public good and insist on payment in goods. But if the alternative to accepting gold was payment in sterling credits, there could be no choice but to ask for payment in gold, since gold might at least keep its value, if not appreciate, while sterling credits might depreciate.

VI. United Nations' Expenditure and the Community's Savings

Success of the measures, which we have outlined above, would, however, depend upon the expenditure of the United Nations being limited to the savings (other than the monetarily

TABLE XXVII

The United Nations' Rupee Expenditure, the Budget Deficits of the Government of India and the National Income

(*Crores of Rupees*)

	1939-40	1940-41	1941-42	1942-43	1943-44	Total
1. Budget Deficits ..	4·00	11·15	12·84	166·33	149·54[6]	343·86
2. The United Nations' Rupee Expenditure ..	92·11	102·82	226·69	433·80	568·09	1,423·51
3. Total of 1 and 2 ..	96·11	113·97	239·53	600·13	717·63	1,767·37
4. The value of 3 at August 1939 prices ..	76·29	99·10	174·84	350·95	302·79	1,003·97
5. 4 as a percentage of the National Income[7] ..	3·47	4·51	7·95	15·95	13·76	9·13[8]

6. Revised Estimates.
7. The value of the national income at pre-war prices has been assumed to be Rs. 2,200 crores.
8. Percentage of the aggregate national income for five years.

imposed savings) of the community, since, in the event of the expenditure exceeding the volume of savings, resort to inflation would be the only way of escape.

But the rupee disbursements of the United Nations are not the sole charge upon the community's savings. The latter must also cover the budget deficits of the Government of India. It follows that the two together must remain well within the unconsumed income of the Indian economy. Whether or not this was possible may be judged from the table below which gives figures of the aggregate magnitude of the budget deficits and the Allied expenditure, their value at pre-war prices and the ratio of the latter to the national income. The table indicates that, on the assumption of the Indian national income remaining unchanged at Rs. 2,200 crores per year throughout the period under review,[9] the ratio of the sum of the budget deficits and the United Nations' expenditure to the national income varied between 3·47 per cent and 15·95 per cent, with an annual average of 9·13 per cent. If we may assume that these percentages do not exceed the capacity of the country to save, with or without the aid of appropriate executive measures[10] to keep down consumption, we may say that the full amount of the Allied expenditure might have been raised through non-inflationary devices.

VII. Distribution of the Expenditure Over the Several Sources

The distribution of the finance over the four several heads might, then, have been done as in the table below:—

9. This assumption is not strictly correct as, with the diversion of men and resources into the war effort and the deterioration of the productive plant, real national income must soon begin to decline.

10. See B. R. Shenoy, *The Post-War Depression and the Way Out*, 1944, Chapter IV.

TABLE

How the United Nations' Rupee Expenditure Might

(*Crores*

	1939-40		1940-41		1941-42	
	Amount.	Percentage of Total	Amount.	Percentage of Total	Amount.	Percentage of Total
1. Merchandise Imports [11]	61·91	65·24	1·74	1·50	71·53	37·71
2. (i) Repatriation of the Sterling Debt of the Government of India [12]	9·36	9·86	81·30	70·01	33·91	17·87
(ii) Repatriation of Commercial and Industrial Investments; 3. Issue of Loans; 4. Sale of United Nations' Gold	23·62	24·90	33·08	28·49	84·27	44·42
5. Monetary Expansion against Sterling Credits	—	—	—	—	—	—
Total[13]	94·89	100·00	116·12	100·0	189·71	100·0

11. Figures against this item have been derived by adjusting the amounts of the surplus exports, as given in Table V, column A, p. 18, above, to August 1939 prices (General Index).

12. Purchase value of that portion of the sterling debt, finance for the repatriation of which was raised through the issue of loans. See Table XXIII, p. 100, above,

XXVIII

have been Met Without Recourse to Inflation

of Rupees)

1942-43		1943-44		1944-45		Total	
Amount.	Percentage of Total	Amount.	Percentage of Total	Amount.	Percentage of Total	Amount.	Percentage of Total
71·35	25·28	59·07	24·65	50·00	20·41	315·60	27·02
71·73	25·41						
		180·59	75·35	195·42	79·59	852·48	72·98
139·20	49·31						
—	—	—	—	—	—	—	—
282·28	100·0	239·66	100·0	245·42	100·0	1,168·08	100·00

13. The amounts of the total expenditure have been obtained by adjusting the figures of the total expenditure, as given in Table XXV, p. 104, above, to August 1939 prices (General Index).

The figures against item (1) in the table are the over-all surplus exports of the country[14] adjusted to August 1939 prices. Finance up to these amounts has been assumed to be possible through the importation of instrumental goods and other supplies for exchange against the industrial and commercial capital in the possession of entrepreneurs. Figures against item (2) (i) represent the repatriation of the Governmental debt effected through non-inflationary methods.[15] They are given separately only up to 1942-43, as the necessary information for their derivation is not available thereafter. The combined figures against items (2) (ii), (3) and (4) up to 1942-43, and against item (2) (i) also for later years, are derived figures: they represent the balance of the amounts necessary to cover the United Nations' total expenditure. In the absence of inflation the money equivalent of this expenditure would be, doubtless, less than actually; in the table it has been assumed to be roughly equivalent to the expenditure as given in Table XXV[16] adjusted to August 1939 prices.

The table indicates that, on an average, as much as 29·62 per cent of the total expenditure for the six years of war might have been met through importing capital, the rest of the expenditure being raised from the remaining three sources. It is, of course, not possible to say in what proportions this might have been effected. But, since the aggregate expenditure is well within the community's capacity to save, it would seem to be far from an impossible feat.

VIII. The Non-Inflationary Methods Would add to the Burden of the War on the United Kingdom

But it must be at once recognized that recourse to the non-inflationary methods of raising rupees would add to the current burden of war finance upon the British economy. In respect of payments in goods this will be felt immediately, the amount of the additional sacrifice imposed being equivalent to the

14. Table V, column A, p. 18, above.
15. Table XXIII, p. 100, above.
16. Pp. 104-05, above.

amount of the expenditure which may be met in this manner. The same would also hold true of payments in gold unless the gold in question was acquired in exchange for sterling credits. The surrender of commercial and industrial investments would amount to killing the goose that has been, for generations, laying the golden egg for the British investor. In the matter of the issue of loans, however, the immediate sacrifice would be equivalent only to the difference between short—and long-term borrowing. But it would, probably, involve loss of prestige to British high finance since it would convert a traditional lender of capital into a borrower from the dependent Empire.

Nevertheless, it is not necessary that this should take away from the magnitude of the British war effort. For, by the adoption of appropriate measures, it is possible to debit the additional sacrifice, instead of to the war effort, to the British standard of living. Notwithstanding the decline in this standard since the commencement of the war, it is still several times higher than the average Indian standard of today as well as of the pre-war period. Relatively speaking, there is, therefore, vastly more room for drawing upon it than upon the later. And, so long as this was so, any failure further to encroach upon the already wretched living standards of the Indian people need not, automatically and inevitably, impinge upon the aggregate war effort of the British nation or of the Empire. Any loss resulting from such failure is capable of being easily restored by asking for a little more sacrifice from the British people. That is to say, it was not as if the only choice was to make the starving man in India eat less, in order to enable the most efficient prosecution of the war. It is possible to leave the Indian standard alone and yet suffer no diminution whatever in the effectiveness of the war effort if there should be no hesitation in forcing down, by a further margin, the British standard of living. And, in view of the prostrate condition of the Indian peasant, to do so would be only to conform to the doctrine of economic, and also moral, equity.

CHAPTER VI

THE PROSPECTS FOR THE FUTURE

I. The Two-fold Aspects of the Problem

Of the sterling assets in the possession of the Reserve Bank, which, at the end of March 1945, amounted to Rs. 1,363·38 crores or £ 1,022·54 million, a small quantity, Rs. 63·94 crores or £ 47.96 million, was inherited from the pre-war period; the rest, Rs. 1,299·44 crores or £974·58 million,[1] was acquired during the 5½ years of war.

It will be recalled that the story behind these assets is that the Indian economy surrendered, from out of its current output, for the benefit of the British Government, £ 974·58 million worth of goods and services, in the course of the several war years. Of this amount, Rs. 562 crores or £ 421·50 million, represented goods which were taken away for use outside the Indian frontiers either in the form in which they were received, as in the case of cloth, other articles of manufacture and foodstuff, or after submitting them to further processes of production, as in the case of raw materials, or by exchanging them for supplies available in the Allied or neutral countries, as in the case of gold, tea, jute and such other commodities. If to this sum we may add the pre-war sterling assets of the Bank, which comprised wholly receipts in final liquidation of the surplus exports of the country, the total amount under this head would come to Rs. 625·94 crores or £ 469·46 million. The rest of the goods and services, worth Rs. 673·50 crores or £ 505·12 million, were consumed within the Indian frontiers in furtherance of the war effort of the Imperial Government. The two together represented that part of the rupee purchases of the United Nations which were paid for in I.O.Us of the British Treasury.

1. On 24 August 1945 the total assets amounted to Rs. 1,495·83 crores (£1,121·88 million); if we deduct from this, sterling held by the Bank in August 1939, the accumulations since the commencement of the war come to Rs. 1,431·89 crores (£1,073·92 million).

The question of the future with regard to these assets concerns, in the first place, the purchasing power of sterling and the possibility, in the second place, of the assets being cashed into goods or the necessary facilities for their multilateral convertibility into foreign exchanges being provided so as to enable importation of goods from outside the United Kingdom and the sterling area.

II. The Significance of the Sterling Assets to the British and the Indian Economies

Before proceeding to examine these issues, it may be useful to have a clear picture of the significance of the magnitude of the sterling assets to the British and the Indian economies respectively. Some rough idea of this may be had when the amount of the assets is set against the national income, the budget expenditure and the volume of the foreign trade of the two countries. The latest available relevant figures are as under:—

TABLE XXIX

The Sterling Assets as a Percentage of National Income, Budget Expenditure and Foreign Trade of the United Kingdom and India

(Crores of Rupees)

	A	B	C	D
	United Kingdom	Sterling Assets (Rs. 1,363·38 crores) as a Percentage of A	India	Sterling Assets (Rs. 1,363·38 crores) as a Percentage of C
1. National Income	11,112·00[2]	12·27	5,368[5]	25·39
2. Budget Expenditure of the Central Government	7,885·20[3]	17·29	512·65[6]	265·95
3. Foreign Trade	2,809·33[4]	48·52	329·02[7]	414·29

2. Net national income at factor cost, which was officially estimated to be £8,334 million for the year 1944. See *An Analysis of the Sources of War Finance and Estimates of the National Income and Expenditure in the years 1938 to 1944*, Cmd. 6623.

Columns B and D of the table indicate sufficiently clearly that, the significance of the Reserve Bank's sterling assets to the British economy is fractional when compared to their domineering importance to the Indian economy. Though they are the result of several years' accumulations, they form but 48·52 per cent of the foreign trade of Britain in 1943 and 12·27 per cent and 17·29 per cent, respectively, of the national income and the budget expenditure, for the year 1944. In contrast they represent as much as 4·14 times the volume of the Indian foreign trade for the year 1943-44, 2·66 times the budget expenditure of the Government of India for the year 1944-45, which was at its all time peak level, and constituted 25·39 per cent of the estimated Indian national income.

While the relative significance in money terms presents a picture of contrast, the real sacrifices at the back of these figures and percentages would contrast even more. The cost in stinting and human suffering at which the Indian economy has built up the sterling assets, were it possible to measure it by a comparable and objective standard, would most certainly be found to be a multiple of the abstinence which the British economy would have to undergo to honour them. This is so for the simple reason that the raising of the sinews of war from a population which, by and large, lives all too close to the margin of bare subsistence, must necessarily amount to a ruthless scraping of the bones and skin, resulting in starvation and also death as has actually happened. The money values conveyed by the volume of the sterling assets, that is to say, express but inadequately the real cost, to the people, of India's contribution to the war effort of the United Kingdom.

Footnotes to Table XXIX, p. 121 above:—

3. £5,914 million, the amount of the Expenditure for the year 1944. Ibid.

4. £2,107 million, the value of the foreign trade for the year 1943. See *Memorandum No. 101*, April 1945, (London and Cambridge Economic Service), p. 10.

5. The pre-war national income of Rs. 2,200 crores adjusted to the 1944-45 General Index.

6. Revised Estimates for the year 1944-45.

7. Figures for the year 1943-44.

III. The Sterling Assets and the British Price-Level

If India must get back from Great Britain undiminished value in real terms for the goods and services surrendered by her for the benefit of the latter, it is essential that the purchasing power of sterling should remain stationary: the sterling price-level at the time of encashment of the sterling assets into goods must not be higher than that at the moment they were passed on to the credit of the Reserve Bank. Since 1939, however, the British price-level has been far from stationary. The Board of Trade General Index rose from 70·6 in August 1939 to 120·3 in December 1944 or by 70·42 per cent. Even assuming that prices in Great Britain did not rise any further, but remained steady at the December 1944 level, the Indian economy would be a loser. An idea of the extent of the loss may be had from the table on p. 124 below.

The figures against item (3) in the table above being the pre-war values of the additions made each year to the sterling portfolio of the Reserve Bank, their total, Rs. 805·41 crores, may be said to represent the sacrifices made by India, in terms of a fixed measure of value, the pre-war British price level. The aggregate war-time sterling acquisitions of the Bank when expressed in terms of the same yard stick of values amount to, however, only Rs. 763·84 crores. The difference between these two magnitudes, Rs. 41·57 crores, therefore, indicates, *at pre-war prices,* the extent of the loss to the Indian economy from the upward trend of the sterling price-level. In terms of the prices ruling in December 1944, the loss would amount to Rs. 70·99 crores.

If sterling should be devalued and prices in Great Britain should rise higher, as, indeed, might happen, the amount of the loss would correspondingly increase for no fault whatever on the part of the Indian economy. And we have no protection of any sort against this encroachment, which, though concealed, is none the less real, upon our rightful claims on the British economy. Protection against devaluation, however, has been allowed to certain other holders of sterling. Under the Anglo-Argentine Payments Agreement of 1940-41, for instance, the value of the sterling balances of Argentina has been guaranteed by a special gold clause; it provides that if

TABLE XXX

Loss in the Real Value of the Sterling Assets

(*Crores of Rupees*)

	1939-40	1940-41	1941-42	1942-43	1943-44	1944-45	Total
1. Progressive increase in the Sterling Assets of the Reserve Bank ..	70·06	2·50	103·65	260·91	437·01	417·32	1,291·45 (763·84)[9]
2. Board of Trade General Index of whole-sale prices[8] (Average) ..	79·71	102·41	111·12	115·37	117·45	119·45[10]	
3. The value of (1) above at the August 1939 price level ..	62·13	1·73	66·52	161·14	265·10	248·79	805·41
The difference between the value of the total sterling assets at pre-war prices and the total of (3) above.							41·57 (70·99)[11]

8. 1924=100; August 1939=70·6.
9. Value of the total sterling assets at the August 1939 price level.
10. Average for 1944.
11. At the December 1944 price-level.

sterling should be devalued against gold, the United Kingdom would reimburse the Central Bank of Argentina by providing the additional sterling required to restore the balances to their former value.[12] The principle underlying the guarantee being undoubtedly a sound one and the justice of it being obvious, if we had the necessary bargaining power, rather than helplessly witness the value of the assets disappear, we should prefer to follow the precedent of the republic. But circumstanced as the country is today politically, we need have no illusions whatever regarding our ability to do so.

IV. The Available Part of the Sterling Assets

Passing on to the question of converting sterling into goods, it must be noted at the outset that the full amount of the sterling assets of the Reserve Bank will not be available for such conversion. Part of the sterling the Bank will need in order to be able to fulfil its own reserve requirements. Under the Reserve Bank of India Act, 1934, it must hold against its note issue a minimum of 40 per cent in gold and sterling. To this must be added a margin of free reserves to be utilized, when necessary, in defending the exchange value of the rupee. It is only the surplus over and above these requirements that may be safely appropriated for non-monetary purposes without, in any way, jeopardizing the currency standard. At the end of March 1945, valuing the gold stocks of the Bank (Rs. 44·42 crores worth) at the statutory price of Rs. 21-3-10 per fine tola, the amount of sterling and gold in the Issue Department of the Bank aggregated Rs. 1,022·74 crores against a note liability of Rs. 1,094·66 crores; that is, the reserve ratio was 93·40 per cent. If, however, we value the gold stocks at Rs. 71-7-4 per tola,[13] the average market price for the year 1944-45, the reserve assets and the reserve ratio would rise to Rs. 1,127·86 crores

12. See Heatherington, op. cit., pp. 38-39; *The Economist*, 20 May 1944, p. 688.

13. The value of the gold stocks at this price would be Rs. 149·54 crores.

and 103·03 per cent, respectively. On this basis the excess sterling assets in the Issue Department over the legal minimum reserve would be Rs. 689·98 crores; and, if from this sum we set aside 15 per cent of the note liability as a free margin, the balance remaining would amount to Rs. 525·77 crores. When to this figure we add sterling held in the Banking Department on 30 March 1945 (Rs. 385·06 crores), we arrive at the final volume of the sterling assets which the Reserve Bank may be asked to release for non-monetary purposes, namely, Rs. 910·83 crores.

These calculations, however, rest on the assumption of an unchanged monetary circulation and an unchanged currency law. If the former should decline and the latter should be suitably amended, both of which, as we shall presently see, are quite feasible, the available portion of sterling may be appreciably larger than the foregoing estimate. A decline in the monetary circulation might take place in the ordinary course: it would result as a direct consequence of sterling exchange being demanded against rupees for cancelling bills representing overall surplus imports: the rupee circulation will, then, fall by the amount of the sterling exchange obtained from the Reserve Bank. It is, however, open to the latter to prevent this from materializing by releasing into circulation equivalent rupee currency through the purchase of government securities or other eligible assets. The same might also happen if sterling exchange was demanded by the State and payment was made for it, instead of through raising loans or from revenue collections, in *ad hoc* government securities. In this case, too, the volume of the assets and liabilities of the Issue Department will remain unchanged; only the volume of the non-sterling assets will increase compensatory to the fall in the volume of the sterling assets.

But, if the Reserve Bank remained neutral, in the one case, and payment was made, for sterling acquired, from the proceeds of revenue, in the other, a fall in the monetary circulation would ensue as but a reflex action of the demand for sterling exchange. And, since the 40 per cent minimum reserve to be held against a diminishing magnitude of the note issue would also diminish simultaneously, it follows

that the surplus sterling resources which the Bank may be able to part with would be larger than our estimate. It is difficult to say in advance, however, what amount of sterling exchange may get released in this manner, since it would depend upon the extent to which currency circulation can contract and the Reserve Bank permitting this contraction to take place. But it is clear that it would represent 40 per cent of the magnitude of the latter. If, for instance, the volume of the currency issue should fall by Rs. 300 crores, the available part of sterling exchange would increase by Rs. 120 crores.

Current theoretical opinion on the subject views with disfavour monetary laws which prescribe a percentage reserve backing to the currency issue, as this locks away, rendering useless for purposes for which they are intended, the minimum of the reserves laid down by law which, more often than not, constitute the largest part of the aggregate reserves. Rather than help to safeguard the currency standard, the proportional reserve system may, indeed, render its position precarious, since, as soon as the free margin of the reserves has been exhausted, they could be touched no more without violating the law. It would seem, therefore, vastly more prudent to allow the monetary authority free use of all its reserves at its own unfettered discretion. Such freedom would, clearly, add to, rather than take away from, the security of the currency system. If, in deference to this reasoning, the currency law of the country should be appropriately amended, as has been done in some parts of the Empire already,[14] and if Rs. 437·88 crores worth of sterling (40 per cent of the note issue), over the whole of which the Reserve Bank would have full right of disposal for monetary purposes, is considered a sufficient reserve, the available portion of the sterling assets, including sterling held in the Banking Department, would be Rs. 1,075·04 crores.

14. Straits Settlements Currency Ordinance, No. 23 of 1938 and the Ceylon Paper Currency Ordinance, No. 21 of 1941. See B. R. Shenoy, *Ceylon Currency and Banking*, 1941, pp. 207 et seq.

V. The Theoretically Possible Alternative Methods of Redemption

Theoretically, there exist eight several ways of how the British Government may elect to dispose of its liabilities represented by the available portion of the sterling assets of the Reserve Bank. They are as under: (1) partial or complete repudiation or some euphemistic or convert version of the same thing; (2) sale to the Government of India of some units of the British Navy or of the Royal Air Force or of the war-time factories and stores situated in India, with a view, no doubt, to strengthening India's capacity for self defence against external aggression; (3) funding the Government sterling liabilities in respect of pension charges, etc.; (4) continuance of the present position whereby exchange restrictions exist only in the matter of transactions in non-sterling currencies, dealings in sterling area currencies being subject to no restrictions whatever so that the sterling assets may get exhausted through trade within the Empire countries; (5) blocking the sterling assets and making them available only in prescribed quantities, over a period of years, by a mutually agreed plan, for the importation of capital goods and other essential requirements for the economic development of the country, from Great Britain and the sterling area countries, wherever possible, and from outside the sterling area, wherever necessary, hard currencies in requisite quantities being provided, in the latter case, by the United Kingdom against equivalent sterling and it being presumed throughout that the needs of India, not the convenience of Great Britain, will be the guiding factor; (6) a modified version of (5) above whereby the sterling assets will remain blocked and will be available only in instalments for the purchase of capital or consumption goods, at first, wholly or mainly from Great Britain and, after a period of years, as the foreign exchange position of the country may improve, also from outside the sterling area in certain restricted quantities, the convenience of Great Britain alone being, in every case, the deciding factor; (7) unblocking the sterling assets, that is, removing all exchange and trade restrictions in India as well as in Great Britain, allowing the

course of exchange and commerce freely to do what it liked with the sterling assets; and (8) sale to the investing public in India of the British-owned capital in Indian industry and trade.

VI. The War-time Accumulated Sterling Assets and the Currently Accruing Sterling

These several alternatives of policy, which may be applied either, any one of them, alone or, any two or more, in a suitable combination, relate, it will be noted, only to the war-time accumulations of sterling and are independent of the course of action which may be pursued in respect of the currently accruing sterling, during the post-war period, in the course of trade. The proceeds of current exports, that is to say, may very well be employed to finance imports from any part of the world, the necessary foreign exchanges, in the case of imports from outside the sterling area, being provided by the Bank of England, without any prejudice whatever to the manner of how the war-time accumulations of sterling may be disposed of. So long as the current liabilities on account of imports, visible as well as invisible, plus payments due on account of Home Charges, did not exceed the value of exports, free multilateral convertibility of the sterling proceeds of the latter may co-exist with a policy of complete or partial blocking of the old sterling assets; indeed, subject to the same limitation with regard to the volume of the external liabilities to be currently incurred, all measures of exchange control may even be withdrawn from transactions arising out of current trade, if technical difficulties were not to interfere with the adoption of such a course.

The blocking of the sterling assets or their regulated use, that is to say, does not necessarily involve the imposition of similar restrictions upon current exchange receipts or upon their disbursal. The old and the newly-to-be-acquired assets may, in other words, be separated, one from the other, and may be subjected to isolated treatment. Our concern here is primarily with the former, which are a legacy of the war.

The condition regarding the currently-to-be-incurred liabilities abroad is important because, if these were to exceed the value of current exports, they would have to be met from out of the past accumulations of sterling, as, otherwise, we would be faced with the problem of a fall in the value of the monetary unit. It would also, simultaneously, take away with it our right of disposal over that part of the sterling assets which would have to be utilized in this manner. This is not to say that full right of disposal over the old assets would necessarily demand that current exchange payments on account of imports can, under no circumstances, exceed current exchange receipts against exports.[15] Only, such excess must not materialize otherwise than in accordance with the policy to be pursued with regard to the disposal of these assets. In respect of alternatives (4), (5), (6), (7) and, partly, also alternative (2), which contemplate redemption of the assets in the currently-to-be-supplied goods and services, the value of the imports, for instance, may exceed the value of exports by the margin by which the assets may be drawn upon in each case. If, however, alternatives (1), (3) and (8) were alone to be resorted to, unaccompanied by any of the rest, the value of the aggregate imports cannot exceed the value of the aggregate exports without violating the discretion with regard to the use of the old assets. For, to the extent this happens, the disposal of the assets would be determined by the forces of trade and not in fulfilment of a pre-conceived plan.

VII. The Multilateral Convertibility of the Sterling Assets

Of the theoretically possible alternatives, the seventh and the eighth may be ruled out as extremely improbable. Taking the former first, the gold and the foreign exchange resources of Great Britain—though statistics on the subject are not available to the public, judging from the general belief with regard to their present volume—would not

15. The concept of excess imports here referred to is the same as that defined on p. 143 below.

permit unrestricted multilateral convertibility of the sterling assets. The gold part of these resources, which in September 1939 was estimated at $ 876 million (£215·14 million), was thought to have fallen to $151 million[16] (£30·55 million) in December 1941. It is not clear what the position is with regard to the dollar assets. But the amount of the sterling balances to be set against them is considerable. As revealed by Sir John Anderson in his budget speech to the House of Commons on 24 April 1945, the aggregate amount of the sterling balances to the credit of overseas countries, principally India, Eire, Egypt, Canada, Australia, New Zealand and the Colonial Currency Boards, to all of which the privilege of free multilateral convertibility would have to be extended, once it was allowed in the case of India, had already reached the figure of £3,000 million at the end of last year and today it is likely to be £4,000 million.[17]

If the existing supplies of gold and exchange for providing free convertibility to the sterling balances are too short, there is not any possibility either of making good the deficit from the current accruals of foreign exchange. Indeed, expert opinion on the subject is unanimous that, so far from the exports of the country yielding a surplus of exchange over the requirements of current imports, for some period of time after the war, the opposite is most likely to be the case. Sir John Anderson in his last budget speech, for instance, expressed the fear that, for the first three years after the war, there may occur 'a very heavy deficit on current account',[18] which will render it necessary to ration out exchange supply, as during the war, in accordance with a planned scale of priorities. Reconstruction of devastated areas, rebuilding of houses and rehabilitation of industry and trade would naturally demand first attention before claims for foreign exchange for other purposes may be considered. And when a surplus did become available, it would have to

16. *The Eastern Economist*, 6 July 1945, p. 5.

17. *Times of India*, 26 April 1945; *The Economist*, 28 April 1945, p. 540.

18. *The Economist*, 28 April 1945, p. 540.

be conserved for the no less pressing programme of recapturing Britain's position as a leading creditor nation of the world.[19]

If so, it is clear that throwing the sterling assets open for free multilateral convertibility would be a suicidal step. It would lead to a scramble for the limited supplies of foreign assets and would thereby seriously jeopardize the post-war economic plans of Great Britain. Nor will the holders of the sterling assets escape damage, as a rush on their part to convert sterling into hard currencies must necessarily produce a serious depreciation in the external value of sterling, which would mean that the sterling securities in their possession would be worth correspondingly less in terms of goods. Their own self-interest in the stability of sterling, in other words, should induce them to impose upon themselves a self-denying ordinance in order to prevent, rather than solicit, recourse being had to alternative (7).

VIII. Repatriation of Industrial and Commercial Capital

Redemption of the sterling assets through alternative (8) may aslo be dismissed as unlikely because, having successfully resisted resort being had to it during the war years, under conditions of inelastic demand for rupee finance, it is exceedingly improbable that the most valuable British investments in this country would be easily allowed to be liquidated after the exigencies of war had passed and at a time when a speedy rebuilding of the overseas investments of the country to its pre-war level should be one of the principal objectives of economic policy[20] with a high ranking priority. For, it is worthwhile noting that the forgoing of handsome dividends is not the only sacrifice involved in such a course.

19. *The Economist*, 28 April 1945, p. 540.

20. It is interesting to note that a writer in *Planning* (15 September 1944, p. 19) dismisses this alternative of redeeming sterling balances as unsuitable to the interests of his country on the ground that it 'would (a) Result in British companies losing control of valuable concerns in India, and (b) Add to (Britain's) long-term Balance of Payments' problem by removing a source of overseas investment income'.

With the title to investments will also go certain advantages which accompany their ownership and the effect of which would be, as we shall presently see, to intensify the long-term balance of payments difficulties of Great Britain in the post-war period.

In the first place there would result, sooner or later, a surrender to Indians, the future proprietors of the enterprises, some of the most highly lucrative positions, administrative and technical, which Indian trade and industry to-day offer, but which, hitherto, have been the almost exclusive preserve of Britishers. Secondly, expensive head offices, now maintained in London or elsewhere in the United Kingdom and the exorbitant directors' fees, both of which yield considerable revenue to the British economy, would disappear with the shifting of control into Indian hands. In the third place, there is no guarantee whatever that these concerns would continue, subsequent to their sale, to provide the same assured patronage to British products of all kinds including British banking, shipping and insurance services, which they have always been doing by force of habit or tradition. On the contrary, there may ensue a natural tendency to transfer such patronage to the Indian rivals of British enterprises. Some of it may also go overseas. To the extent this may happen, British exports, visible and invisible would suffer.

Finally, ownership of the investments, which are spread over every facet of the economy, meant a living contact with what is comparatively an undeveloped economy with vast untapped potentialities for profitable investment. These contacts provide the British investors, seeking outlets abroad for their capital, a fund of local knowledge and experience to guide them over practically every sphere of economic activity. They enable British capital to secure easy and lucrative openings, through the device of expanding existing enterprises or by establishing new ones. These advantages would begin to disappear with the progress of repatriation.

British interests apart, from the Indian standpoint, the desirability or otherwise of exchanging sterling balances for British investments would depend upon four factors: (1) the average price at which they would be put on the Indian market; (2) the availability or the opposite of capital goods in

sufficient quantities for implementing schemes of economic expansion; (3) the presence or the absence of the danger of the sterling assets being frittered away in the purchase of consumer goods; and (4) the post-war purchasing power of sterling.

It is clear that, to make the transaction worthwile, the average price at which British investments would be made available must be capitalized at a rate of interest which is not less than the prospective returns on new investments. Capitalization at a lesser rate would place the balance of advantages on the side of utilizing the sterling assets for financing projects of economic development at home, as that would, then, cost less, and bring higher dividends, than the repatriated British investments. But it is important that the purchasing power of sterling between now and the time of cashing the sterling assets into goods must not fall by a margin which may more than negative the difference between the cost of new investments and the price of the old. For, in the event of its so falling, the relative advantage of new investments over the old would disappear and it would be the purchase of the latter, not the undertaking of new investments, which, in the circumstances, would become more profitable.

It is clear, too, that if Great Britain should be unable to supply the necessary capital goods or, alternatively, the requisite amount of foreign exchange for importing such goods from elsewhere, in the quantities desired, and if the sterling assets should consequently remain blocked indefinitely, earning only a nominal income of about 1 per cent., it will be desirable to acquire British investments in exchange for them, rather than retain them in liquid form. The advantages of such a step would remain even if the potential yield on the forbidden new investments, were to be higher than the yield on the old, since the latter would, in any case, be larger than the yield on sterling treasury bills. British investments would be preferable also, if the sterling assets were otherwise in danger of being bartered away for consumer goods. The utilization, for the latter purpose, of sterling acquired at such immense human suffering would be most unfortunate. Since, however, for the reasons we have reviewed above, the likelihood of

Great Britain being agreeable to part with her investments in India is exceedingly remote this question of the desirability or otherwise of our acquiring them may not arise at all.

It has been different, however, with South Africa, a country which is virtually sovereign politically. She, too, like India, was faced with the problem of sterling accumulations, which were received in payment of surplus exports. Some of it was utilized for repatriating the sterling debt of the Government. But, since sterling continued to flow in, other uses had to be found for it;[20a] and it is significant that the Government decided that this should be the buying over of foreign investments (principally British) in the Union. For this to happen on a sufficiently large scale it was necessary that steps should be taken, on the one hand, to depress their price and, on the other, to stimulate the demand for them. With a view to bringing about the former, the Government levied a discriminatory tax on dividends paid to non-resident holders of South African securities,—a measure which, incidentally, under the Act of Parliament, 1935, is beyond the competence of the Government of India; and with a view to bringing about the latter Mr. Hofmeyr, Minister of Finance, appealed to the private, corporate and public investors to keep the movement of repatriation going by purchasing South African securities in the London market.

As a result of these measures, not only was inflation held in check but the external indebtedness of the country was considerably scaled down.[20b] Canada, too, pursued a similar policy whereby Canadian dollars to finance British expenditure in the Dominion were provided through the repatriation of Government stock as well as equities and other private investments held by Britishers.[20c]

20a. The South African Government also pursued the negative policy of preventing sterling accumulations by taking gold instead. See Heatherington, op. cit., p. 35.

20b. See *The Economist*, 8 January 1944, p. 50.

20c. Heatherington, op. cit., p. 12.

IX. Repudiation of Debt or Re-negotiation of the Financial Settlement of 1939

Alternative (1), at any rate, in its downright form, is also not likely to be resorted to. Outright repudiation of an honourable debt is not only derogatory to the prestige of Great Britain but the circumstances of the case would render any such move wholly uncalled for. For, Britain's position of authority in India should easily enable her to negotiate almost any solution, less dis-honourable than repudiation, which would satisfy her requirements more or less completely.

This does not, however, rule out the possibility of part of the sterling debt being cancelled through some less objectionable device without giving anything in exchange for it. Great Britain, for instance, may ask for, or the Government of India may offer, a contribution towards the Imperial war expenditure in India in recognition of the services rendered by the British armed forces in defence of India and for saving it, to quote the *Financial News*, (London), 'from becoming a Japanese Colony'. Something similar was done at the end of the last war and, during the present, Canada has already set a precedent by making a free gift to the British Treasury of \$1,000 million (£248·14 million), in addition to an interest-free loan of \$700 million (£173·70 million) and other forms of mutual aid.[20d] It may be argued that India has not as yet rendered any assistance on these lines and, aspiring as she does to the status of a dominion, it is but proper that she should follow the good example of Canada.

The same result can also be attained by a re-negotiation of the Financial Settlement of November 1939, whereby the ultimate liability of the war expenditure in India is apportioned between this country and Great Britain. Much adverse comment, at times even of quite an irresponsible character, has been made on the terms of this settlement in the British Press. The following extracts are some samples of the kind of propaganda that is being carried on:

20d. See *The Economist*, 25 March 1945, pp. 394 and 408.

1. 'But India herself would have something to gain from a re-negotiation of the Financial Settlement which would give her the chance of a more favourable settlement of her rapidly increasing claims on Great Britain. The bigger that claim, the smaller becomes the chance of converting it from its present virtually blocked character into a multilaterally convertible asset. The whole of the Indian monetary structure is based on sterling and by undermining the latter, India will be injuring her own interests.'—*The Economist*, 3 June 1944, p. 755.

2. 'The case for revision..........also rests on the fact that Allied purchases in India have been made at inflated prices which, owing to the control of the exchange market, have not been allowed to reflect themselves in the exchange rate of the rupee..........The accumulation of sterling assets by India has, therefore, been considerably stimulated by the rise in rupee prices......If only on this comparison of the real terms of trade between the two countries there would seem to be strong grounds not merely for a re-negotiation of the settlement, but for some retrospective reconsideration of the debt to which it has given rise.'—*The Economist*, 17 June 1944, p. 820.

3. 'The fairy princes of Whitehall have generously rewarded the poor nations of the East—endowing them with undreamt of riches overnight, leaving a treasure of £50 million in Baghdad, £100 million in Jerusalem, £200 million in Cairo, £1,000 million in New Delhi and so forth'........Paul Einzig in *The Banker*, December 1944.

Though it may be at once agreed that the stability of sterling must remain a matter of vital concern to India, the argument of *The Economist* that India herself stands to profit from writing off a part of the sterling assets would seem somewhat disingenuous. For, while the advantages of such a step to the British economy are quite obvious, it is far from clear how the Indian economy can benefit by forgoing its legitimate claims upon the British economy which were created through self-denial. If, indeed, the piling up of British war expenditure in India should threaten to reach a point at which, in the opinion of this journal, the post-war value of the pound would be rendered extremely vulnerable, it is an indication

that Great Britain has spent or is spending beyond capacity. And the proper remedy for this is for Great Britain to try to spend less or to impose greater sacrifices upon the British public in order to be able to honour her debts; and for India to try to protect the value of its sterling possessions in the manner done by Argentina. The remedy is not to ask India to treat the goods and services, she surrendered during the war, as a free gift to Great Britain. Whilst there was still room for a reduction in the British standard of living, and not until the latter was reduced to the Indian level, the plea for writing off the sterling debt can have no justification whatever, either moral or financial.

The theory that a revision of the Settlement was justifiable on the ground that the sterling equivalent of the rupee expenditure has been unduly inflated, seems at first sight to be sounder and has been more widely advocated.[21] The argument is that, since prices in India have risen much more steeply than prices in Great Britain, without any reduction being effected in the sterling value of the rupee, a given amount of rupee expenditure would get converted into a larger quantity of sterling than would be the case if the rate of conversion were to reflect the correct value of the rupee. And the greater the inflation in India and the higher the Indian prices may rise, as a consequence, the larger becomes the disparity between the amount of sterling received by India and the amount she is really entitled to. *The Financial News* has gone a step further than *The Economist* and has estimated that, if allowance was made for the changes in sterling and rupee prices, a reduction of £127—£163 million would result, up to the end of March 1944, in the sterling assets then accumulated with the Reserve Bank (£709 million) and that the current rate of accumulation would be approximately halved.[22] In the opinion of the journal this operation would

21. See *Planning*, 15 September 1944, p. 19, and *The Financial News*, 16 June 1944.

22. Quoted by *Planning*, 15 September 1944, p. 19 and *The Eastern Economist*, 14 July 1944, p. 38.

amount to no more than 'squeezing the water' from out of the sterling balances.

But in making out this bill, no notice whatever has been taken by the journal of the several items on the debit side of the account. In the first place, though prices in India did move up with the progress of inflation, British and Allied expenditure was incurred at controlled prices which were materially below *market prices*. And, as has been pointed by *The Eastern Economist*,[23] full advantage was taken of Britain's power of authority in India to depress, or to prevent a rise in, the prices of commodities in which the British Government was interested. In respect of hides and skins, for instance, the purchasing governments, by mutual agreement, eliminated competition among themselves and, with a view to checking internal sales of these articles at higher prices, transport permits for them to inland centres were restricted to 25 per cent of the sales to the British Ministry of Supply. The artificial immobility thus created enabled the unified buying organization of the Allied Governments almost to dictate its own price. Similar devices were also employed in the case of linseed, groundnut and other oilseeds.

And the *Fourth Report of the Parliamentary Committee on British Expenditure in India* has stated that the prices at which purchases in India were made have been fair and reasonable and that they have been generally, and in some cases markedly, lower than the corresponding prices in the United Kingdom. The prices of Tata steel, the bulk of which was turned over to the Government, recorded no rise at all for the first three years of war and even today were only 27 per cent above pre-war; the Government was able to purchase cloth at 200 (January-March 1940=100) and subsequently at 170, while the price for the civilian consumer had reached the peak of 500 in the first quarter of 1943 and was 260 in the first half 1944. The Committee observes that the purchases have 'escaped the worst fluctuations of Indian commercial prices'.[24]

23. 8 June 1945, p. 750.

24. Quoted by *The Eastern Economist*, 8 June 1945, p. 750.

In the second place, for the rupee proceeds of the goods imported into this country the British exporters received more sterling than they were entitled to. They realized a bounty to the extent of the over-valuation of the rupee. The British and the Allied Governments would not have made the harvest of profits, which they actually did, on their sales of gold, if the sterling value of the rupee had been adjusted to its correct par. Furthermore, since sterling prices have not remained stationary, but have increased, allowance must be made for the resulting loss in the real value of the sterling assets.[25] Finally, having inflated Indian currency for her own advantage, it does not lie with Great Britain to turn round and say that prices have risen too high or that exchanges have failed to fall. If inflationary finance had not been resorted to, the British demand for rupees would have driven up the exchange ratio much above 18 d. and the sterling cost of a given amount of rupee expenditure would, then, have been vastly more than to-day.

When due values are given to these several factors, the point made by *The Economist* and *The Financial News* would lose much of its force; indeed, so far from a writing off of the sterling assets being indicated, it might turn out to be just the opposite. But there is certainly no guarantee that recourse will not be had to this alternative, whatever may be the injustice of it to India. For, past experience has shown that high financial policy in this country is rarely, if ever, governed by expert Indian opinion on the subject; it is governed all too often by British expert views of what constitutes Indian interests. The game is too well known to need elucidation.

Dr. Paul Einzig's 'fairy princes of Whitehall' need not detain us long. For, we are well aware that what they have left in this country is not a treasure of undreamt of riches, but misery, starvation, disease and death and on a scale unprecedented even for India. They are only the debit side of the account of which the credit side is represented by the sterling assets. And Dr. Einzig, no doubt, realizes that to alter the Financial Settlement in Britain's favour would make no

25. See Table XXX, p. 124 above.

difference whatever to India's current contribution to the war. It would merely reduce her post-war claims on Britain, without taking away anything from her war-time suffering. To leave behind less sterling than was due, or to conjure away a part of it subsequenty, would, therefore, be quite mean of the fairies.

X. Sale to India of the War-time Factories, Air-fields, Etc.

Drawing upon the sterling assets for implementing alternative (2) would seem to be fairly probable. For, sale to the Government of India of the factories, air-fields, stores and other equipment[26] owned by the British Government may prove to be the only practical way of disposing of them, since their transhipment to the United Kingdom would be either not possible, as in the case of air-fields, or not worthwhile, as in the case of factories and the like. If to these while, as in the case of factories and the like. If to these are added some naval units and fighter planes, which, during the war, had mostly remained in the Far East, while the aggregate fighting strength of the Empire will remain undiminished, they may materially contribute towards a reduction of the sterling liabilities of the British Government.

The advisability of India accepting payments in this manner would, however, depend primarily upon whether we would really be in need of these factories, naval units, etc., immediately after the war or whether their acquisition could be postponed, without sacrificing security, to some later date and, thereby, allow priority, over external assets, to the claims of the more pressing needs of industrialization. Great Britain's necessity or convenience must not be allowed to

26. The aggregate amount of the stores which will remain in India at the end of the war has been estimated to be 'about Rs. 100 to 125 crores plus other capital assets of great value'. See *The Eastern Economist*, 3 August 1945, p. 155. The same journal (the issue of 17 December 1943) had estimated that, in December 1943, the value of the British Government owned factories and stores was about £26 million.

over-ride the importance of conserving our foreign exchange resources for the importation of capital goods and other essential supplies. The question requires careful investigation, though it may be added that here, too, Indian opinion is more likely to be ignored than respected.

XI. Capitalization of Pension Charges

The Finance Member in the budget speech of 1943-44 had announced that redemption of part of the sterling debt through alternative (3) was under consideration of the Government of India.[27] Nothing, however, was heard of it thereafter. No reference was made to it in the budget speeches of 1944-45 or 1945-46. Since it is not clear why the idea was shelved, it is difficult to say whether it is likely to be reopened after the war. The amount of the pension to be capitalized is believed to be about £5—£6 million a year and on a 3 per cent interest basis, the lump sum payment to be made would come to £160—£200 million. The transaction, it will be noted, would amount to making advance provision for the annual sterling remittances, the British Government undertaking to find the necessary amount of it at the due dates in return for the capital sum now received, though the legal liability for the payments due would remain that of the Government of India. It would be merely a case of the purchase by the latter of a sterling annuity. But in face of the more urgent necessity of speeding up the economic development of the country, it is not easy to see why we should be in any desperate haste to seize hold of every possible device of disposing of the sterling assets. As we shall presently see, it is not as if their magnitude is larger than would be required for purposes of industrialization.

XII. Continuance of the Status quo

Alternative (4) contemplates the free use of the sterling assets for the purchase of whatever goods may be available

27. Pp. 18-19.

in Great Britain and other countries of the sterling area. This must soon lead to imports on a scale which would exceed that permissible against payments from out of the proceeds of current exports, due allowance being made from the latter for meeting the invisible liabilities of the country. The idea is that the sterling assets would then be drawn upon and cancelled in payment of the surplus imports thus defined. Its implication for Great Britain, however, is that in exchange for exports paid for in this manner she can command nothing whatever by way of imports. They would only draw blanks in the shape of the war-time accumulated sterling securities. They would be, so to speak, gratuitous exports. This is clear when the exports in question are made directly to India; it should be clear, too, when Indian purchases are made from outside Great Britain but from within the Empire, as the countries receiving sterling from India may pass it on to Great Britain in payment of goods purchased by them from the latter.

And, obviously, this is not a matter to be trifled with. For, it would amount to a diversion of resources, away from the solution of the pressing problems of rehabilitation of the British economy, into producing capital and consumer goods for the benefit of overseas dependencies in liquidation of the debt owing to the latter. Moreover, since the magnitude of the debt is very large, the diversion would have to take place on a considerable scale. And, while Great Britain was occupied in this process of debt liquidation, which may take several valuable years of the post-war period, her rivals in world trade might steal a march over her, and she may lose for ever the opportunity of a speedy return to her pre-war position of power and strength, as she would, then, be denied the full advantages of a sellers' market, which must prevail during the first few years of the transition. Since, however, this would be too heavy a price to pay, Great Britain may possibly decide that the debts, however honourable, may wait in order to yield place of priority to the reconstruction of Britain's economic eminence.

This line of argument, it must be noted, presumes that, with the cessation of war, the war-time controls on trade and shipping will be removed, allowing unrestricted movement

of goods as between the Empire countries. The consequences, however, need not be quite so serious, if these restrictions remained, since, through their instrumentality, it is possible so to regulate the volume and the content of the British and the Empire exports to India as not, in any way, to interfere with Great Britain's post-war economic programme. The excess Indian imports, in the sense in which we have used the term, may not, then, be allowed to appear at all or may be kept within the capacity of Great Britain to pay, according to requirements. The trade restrictions in Great Britain may be made to ensure that due attention was paid to British interests first and the restrictions in India may ensure that the aggregate excess imports to be paid for from the sterling assets, whether received from Great Britain or from other parts of the Empire, remained well within the limits of the convenience of the British economy.

If so the possibility of recourse being had to this alternative would depend upon the continuance of the war-time controls on trade and shipping, at any rate in so far as Indian imports from the sterling area countries were concerned, until the volume of the surplus sterling assets were all exhausted or were reduced to innocuous proportions. Since, however, Great Britain may like to spread her payments over a long period, may be as much as two to three decades or even more, and since, on general grounds, it may not be desirable or practicable—in face of the clamour of the public to be rid of them—to continue these controls quite so long, it seems reasonable to anticipate that the chances of resort being had to this alternative, beyond a restricted period, if at all, are not very great.

From the Indian standpoint it is not very attractive either. For, in the event of the barriers to trade within the Empire being removed, there is a very real danger of a considerable proportion of the sterling assets being squandered away in the purchase of consumer goods, of which the country has been starved for the past several years, at fancy prices in a sellers' market. This may happen because the demand for these goods is likely to be so great that their imports may very well exceed the amount of sterling available for their purchase from out of the proceeds of current exports, render-

ing inevitable encroachment upon the war-time accumulated sterling assets. And to the extent this may be the case, the hope of utilizing the assets for the industrialization of the country would be frustrated. If, on the other hand, the barriers to trade were to continue, the result is not likely to be any the better, since there is in it the possibility of Great Britain passing on to us in exchange for the assets, anything from aspirin, mouth organs, old clothes, shoes, second-hand wireless sets, etc., to rejuvenated textile and other machinery. These would represent but a poor memorial to the suffering which we have undergone in building up the assets.

XIII. Utilization of the Assets Solely for Indian Economic Development

Alternative (5), circumstanced as we are today, is purely of a theoretical character, since its execution would imply unfettered political sovereignty plus the necessary power to ensure that the requirements of the reconstruction of the British economy were placed but second in order of preference to the industrialization of the Indian economy, in the matter of the provision of capital and other essential supplies or the release of the necessary hard currencies in exchange for the sterling assets. Nevertheless we may pay some attention to this wholly academic pursuit for its own sake.

In deference to the almost universal desire in the country, this alternative aims at, and is designed for, utilizing the sterling assets wholly for Indian economic advancement. Primarily with a view to preventing their being devoured by the hungry consumer, it proposes, therefore, to block the assets forthwith upon the termination of the war. Blocking has also two other advantages. In the first place, with the removal of the hindrances to sea-borne trade, forces tending to bring about equivalence between equilibrium parities and exchange rates will begin to assert themselves in India as elsewhere. When this happens it would be exceedingly difficult, if not impossible, to maintain the rupee at its statutory par of 18 d. For, as may be seen from the table below, there has taken place in India inflationary expansion

TABLE XXXI

Index Numbers of Inflation and Prices in India and the United Kingdom[28]

(*July* 1939=100)

	India			*United Kingdom*		
Last quarter of	Note Circulation	Demand Deposits	Wholesale Prices	Note Circulation	Demand Deposits	Wholesale Prices
1939 ..	122	103	129	105	108	119
1940 ..	129	125	121	118	136	149
1941 ..	167	165	154	141	173	158
1942 ..	311	253	218	173	187	164
1943 ..	464	367	316	202	211	165
1944 ..	567	458	299	234	237	170

of money on a vastly larger scale than in the United Kingdom. Whereas the wholesale price index in India rose from a base of 100 in July 1939 to 299 in the last quarter of 1944, the British wholesale index rose, during the same interval, only to 170.

As a matter of fact the divergence in the purchasing power of the rupee and sterling is much larger than these figures might indicate, since the Indian price index is only a 'controlled' index, based as it is on controlled prices. A comparison of the trends of note circulation, demand deposits and price indices in India strikes one with the strange phenomenon that, whilst the former continue to move upwards unabated, the latter comes to a dead stop somewhere in the last quarter of 1943, parts company with the trend of money and even takes a turn downwards. In fact everything continues to move upwards, as usual, except the Economic Adviser's index number. But it is not as if the quantity

28. Taken from the *Reports on Currency and Finance for* 1942-43 1943-44 and 1944-45.

theory of money suddenly decided to cease functioning in deference to Defence of India Regulations. The explanation is that it is the index number, not prices, which paid *salaams* to the price control orders of the D.I.R.[29]

In the circumstances, to leave the sterling assets unblocked and for the currency authority to attempt to maintain the rupee at its statutory par, as it may, then, be drawn into doing, is likely to be a very costly policy, besides probably proving futile in the end. If we may accept Dr. S. K. Muranjan's estimate[30] that the real value of the rupee is nearer 12 d. than 18 d., it would amount to little else than drawing upon the sterling assets for subsidizing British and other foreign imports into the country by as much as about 50 per cent. Blocking the assets would protect them from being consumed away in this manner.

In the second place blocking would keep the sterling assets beyond the reaches of the speculator. The disparity between the statutory and the real values of the rupee being very pronounced, with the prospects of the removal of the restrictions on trade, there is a danger of a speculative shifting of funds from India to Great Britain with a view to taking advantage of the possible fall in the value of the rupee. This would assume the form of a transfer of the sterling assets from the Reserve Bank to the exchange banks, to the credit of the speculators, and the amounts involved may be very considerable and may grow in volume as the impossibility of keeping the rupee at 18 d. becomes more and more apparent.

29. But it is quite amusing to read the earnestness with which the Economic Adviser's index numbers have been quoted, and graphs drawn with their aid, in support of the thesis of the 'success' of the anti-inflationary measures of the Government. Says Sir Jeremy Raisman in his last (1945-46) budget speech (para. 30): "Most of the usual indices responded encouragingly...... (to the various anti-inflationary measures) ......The general index number of wholesale prices of the Economic Adviser has, for instance, ranged between 240 and 250 approximately since May 1944......*Honourable Members will find graphs giving the main indices in the Explanatory Memorandum*'. (Italics mine).

30. S. K. Muranjan, 'A One Shilling Rupee', *The Eastern Economist*, 8 February 1945 and 15 February 1945.

To the extent such transfers may take place, the utilization of the exchange resources for a planned programme of industrialization would become difficult, since they may, then, be converted into either consumption goods or capital goods by those who may gain possession of the exchanges from the banks. And if this must be prevented from happening, the steps to be taken would have to be vastly more onerous than when the assets are centrally pooled in the Reserve Bank.

After having effectively locked up the sterling assets in this manner, they would be released only for the payment of capital goods and such other requirements for the building up of the Indian economy, the necessary measures being adopted to ensure prevention of their leakage into other uses. Care must be taken, for instance, to see that imports of capital goods, which would be ordinarily set against current exports, are not paid for, instead of from current receipts of exchanges, from out of the sterling assets, since this would create the possibility of the exchanges, thereby made available from the current receipts, being utilized for the import of consumer goods. This would be clearly a case of the sterling assets being drawn upon, indirectly, for purposes other than intended.

The release of the aggregate amount of the assets would be spread over a period of years in accordance with the absorptive capacity of the Indian economy. This would depend upon the volume of the currently accumulating savings and the amount of the specialized machinery, materials and experts, to be imported from abroad, which these savings can 'take' in order to yield the best results; the sterling assets would be employed to make good the deficits in the supply of the currently available foreign exchanges for acquiring the latter. If we may assume the deficits to be about Rs. 100 crores per year, the blocked sterling resources would last for about ten years.

Nor need this cause any very excessive strain upon the British economy and standard of living. For, it would represent under one (0·89) per cent of the British national income. The productive organization of Great Britain should be easily able to take so small an incidence in its stride. India was

called upon to make and has made vastly greater sacrifices during the war for the sake of victory. She relegated everything else into the background. After victory has been won, it would not be fair to ask her to wait until British reconstruction was over, especially when the self-denial demanded by her requirements is comparatively negligible. It may be noted that India surrendered, on an average, about Rs. 244 crores worth of her current output for the benefit of Great Britain during the war; for the past three years the average was Rs. 372 crores. What she would require each year would be but a fraction of this amount. Is it too much to ask from a country, which is several times richer than our own, for repayment, in ten years or more, of a loan which was extorted from us in five years?

The conservation and the release, by instalments, of the sterling assets for the industrialization of the country would not in themselves render the position free from all difficulties. So long as over-valuation of the rupee remained, the consequent inherent instability of the situation must continue. The tendency for the speculative export of capital and the temptation to import beyond capacity, as measured by the volume of current exports, may possibly exert so severe a strain upon the available supply of foreign exchanges that, under pressure of it, the currency standard may be jeopardized. And, since an unstable monetary system may prove prejudicial to the unhindered progress of industrialization, it would be eminently desirable to root out the cause of the trouble. This may be done by devaluing the rupee to its correct parity and by taking such steps as may be necessary to prevent the value of current imports from overshooting their mark.

XIV. Redemption at the Convenience of the United Kingdom

There remains to consider alternative (6). As under alternative (5), of which this is a modified version, the sterling assets in this case, too, will remain blocked for use within as well as without the sterling area, though the principal objective of doing so would be to prevent any rush

for their conversion into goods on a scale which may hamper Britain's post-war plans of development, through intensifying, what has now become fashionable to describe as, her balance of payments problem. It follows that the period for which they would be put out of use, or the pace at which amounts may be released from them, must conform to the needs of Great Britain. Possibly, to begin with, during the first few years of acute stress, the assets may be kept wholly frozen, none of it being made available either in Great Britain or outside. Even after this stage has passed it may not be permissible to release more than nominal quantities, their use being restricted to the United Kingdom or to the sterling area. It would be only gradually that more liberal rations may be allowed and their conversion into hard currencies would have to wait until the dollar-exchange position of Great Britain materially improved.

For how long the assets may have to be held in a wholly frozen condition, the rate at which they may be made available thereafter, what part of the latter may be exchanged for hard currencies and so on, it is not possible to state with precision in advance. All this would clearly depend upon the needs and the convenience of the United Kingdom. But the late Finance Member of the Government of India, Sir Jeremy Raisman, was of the view that the 'transfer difficulties associated with the balance of payments position' of Great Britain may last 'at least the first post-war decade' and he cautioned his audience not to be too liberal in its estimates regarding the convertibility of the sterling assets into capital goods during the period, since the 'competing claims for capital equipment'[31] of his own country will have to be first attended to.

The P.E.P. (Political and Economic Planning), a non-party group in Great Britain comprising nearly every vocation of life, who may be taken to represent informed and also enlightened opinion of the British public, are less specific on the subject, though they, too, link up the issues

31. *Budget for 1945-46-* p. 16.

we are considering with their view of Britain's balance of payments problem. This problem, they state, arose from the heavy fall in the British overseas investments, the decline in the income from shipping and other invisible items and the fall in visible exports by about 71 per cent. Shortage of exchanges to pay for imports must, therefore, continue after the war and it would be necessary to retain strict import controls in order to limit imports to 'bare essentials.' Even so, increase 'at least 50 per cent over their pre-war level,[31a] or by to be able to pay for these, the visible exports would have to more than 400 per cent over their 1943 level.' Until this was attained, payment of the sterling assets from 'out of current production will be impossible except by means of blocked balances for the purchase of British goods.' In the matter of the multilateral convertibility of the assets, they are prepared to consider this question only '*if and when*[32] Britain's exports yield more than enough foreign currency to pay for her essential current imports.'[33] And, doubtless, it may be very long before Britain may be said to have had enough.

This target for British exports has received almost universal approval in Great Britain and the necessity for reaching it as speedily as possible, before paying attention to anything else, has been widely emphasized. *The Economist*, for instance, regards it as 'second only to victory' and would put up the slogan 'export or die,' since increased exports are 'vital to the future welfare of the British community.'[34] If these

31a. In 1938, total British exports were valued at £470 million. At 1938 prices, a 50 per cent increase would mean exports to the value of £705 million; at 1944 prices, which were 78 per cent higher than in 1938, the target figure would be £1,255 million. And in 1944, the volume of exports was one-third of what it was in 1938.

Judging from the experience after World War I, nor is the attainment of the level aimed at by any means a simple affair. In 1919 the volume of exports was 45 per cent less than the 1913 level; in 1920 it was still 29 per cent below the latter; and during the subsequent two years it suffered a decline.

32. Italics mine.

33. P. E. P. letter to *The Eastern Economist*, 19 January 1945, p. 80.

34. *The Economist*, 27 January 1945, pp. 101-02; also see *The Economist*, 19 May 1945, p. 663.

views should prevail, the redemption of the sterling assets may not materialize at all before British exports recover to the desired extent.

It must not be presumed, however, that redemption would be freely permitted soon thereafter. For, it must be noted that a 400 per cent increase in exports over the 1943 level is expected to permit only the bare essential imports. If the latter must return to their pre-war norm, exports must rise still higher. Provision must be made, too, for recapturing Britain's position of financial supremacy. This would absorb all the foreign exchange which the surplus British exports may provide for a long many years, may be several decades. That is to say, once priority to the needs of Great Britain is granted and the liquidation of the sterling debt is left to her convenience, as is done in this alternative, it becomes at once difficult, if not impossible, to anticipate a date by which the sterling assets may be freely utilized to meet Indian requirements. There can be room for releasing them only in driblets.

XV. The Sterling Assets and the International Monetary Fund

This would seem to provide the correct explanation for the falure of the British *Proposals for an International Clearing Union (Keynes Plan)* to make any specific provision for the clearance of the sterling assets through the Union. The *Proposals* merely state that 'it is very desirable' that the countries owning these balances 'should regard........as liquid' a portion of them 'over and above the amounts which they can afford to lock up.' This it would do by 'some special over-riding provision *for dealing with the transitional period only*'[35] whereby 'through the aid of the Clearing Union, such balances would remain liquid and convertible into bancor by the creditor country whilst there would be no corresponding strain on the bancor resources of the debtor country, or, at any rate, the resulting strain would be spread over a period."[36]

35. Italics mine.

36. Para. 34 of the *Proposals*,

That is to say, the British Treasury would have no objection to a restricted portion of the assets being allowed facilities for multilateral convertibility, during a transitional period, from out of the general funds of the Union, on the additional condition that Britain's exchange resources were not in any way encroached upon.

That it would not suit British interests for the country to be pinned down to any specific scheme of redemption whatever, is evidenced by the fact that the provisions of the *United States Proposal for a Stabilization Fund* (*White Plan*) or those of the *Proposals of Canadian Experts for an International Exchange Union* were not acceptable to Great Britain and the British delegation to the United Nations Monetary and Financial Conference held at Bretton Woods in July 1944 strongly opposed, and secured rejection, by the Conference,[37] of the Indian proposal to bring the war-time sterling balances within the purview of the International Monetary Fund. And the Final Act of Bretton Woods expressly stated that the 'Fund is not intended to....deal with international indebtedness arising out of the war'.[37a] It may be noted that the Canadian plan would spread redemption of the debt over a period of 20 years at the rate of 5 per cent per annum[38] while the U.S. plan would spread it over 53 years at the rate of 2 per cent per annum.[39] Great Britain was not prepared even to discuss these suggestions. She would leave the question for settlement by bilateral negotiation only.

XVI. The Empire Dollar Pool and the Indian Dollar Fund

The locking up of the sterling assets, that is, the postponement of their conversion by Great Britain into goods or foreign

37. *Commerce*, 26 August 1944, p. 250; both the British and the American delegations to the Conference had issued statements rejecting the use of the Fund as a mechanism for liquidating the balances.

37a. Article XIV, § 1, p. 27.

38. Section VIII, p. 17 of the *Proposal of Canadian Experts*.

39. No payment would be made for the first three years. See the *United States Proposal*, 8 (f), p. 4.

exchanges does not imply, it will be recalled, similar treatment being extended to sterling or other exchange acquired in payment of current exports. So far from being unwilling to sell goods to India against the latter, she will be, in fact, only too pleased to do so, since by purchasing freely the exportable surplus of British goods against the proceeds of Indian exports to the sterling area or to the hard-currency countries, India would help to solve Britain's balance of payments problem. And in order to ensure that as much of the hard currencies accruing to India as possible were made available for the finance of British economic reconstruction, the prevailing exchange control regulations and the Empire Dollar Pool may be retained. The controls will be so worked that India bought less from, than she sold to, countries outside the sterling area.

From the Indian standpoint, however, though it would be desirable to continue the controls over current exchange transactions, the object of their working ought to be somewhat different. Rather than be a milch-cow for yielding dollars for the benefit of the Empire Pool, the aim should be to keep down consumer imports to a minimum in order to make room for essential capital goods, materials and technical experts. It would also be desirable to keep out of the Pool, since by remaining in it there is a greater chance of our getting less, never more, than what we would currently contribute to it. This is, in fact, what happened during the six years of war. The aggregate dollar contribution of the Indian economy to the Empire Pool would comprise India's favourable balance of trade with the U.S.A. and Canada *plus* that part of the war expenditure of these two countries in India, which is not covered by the figure of surplus exports and which was not met in gold. But we have information on none of these factors and it is, consequently, not possible to have a correct idea of the Indian contribution; the table below, however, gives figures of the amount of the surplus exports of the country, on private account, with the U.S.A. and Canada for the five years ending with 1943-44:—

TABLE XXXII

India's Balance of Trade on Private Account with the U.S.A. and Canada

(Crores of Rupees)

	1939–40	1940–41	1941–42	1942–43	1943–44	Total
U.S.A. ..	+12·56	−1·11	+11·98	+8·78	+21·89	+54·10
Canada ..	+ 2·75	+0·20	− 0·26	−1·75	+ 2·41	+ 3·35
Total ..	+15·31	−0·91	+11·72	+7·03	+24·30	+57·45 ($172·35 million)

The table reveals that from the restricted field of trade in merchandise on private account alone the Empire Pool benefited to the extent of Rs. 57·45 crores ($172·35 million). The actual receipts were, doubtless, vastly larger. It is worthwhile noting that this benefit was extorted through denying to the Indian economy dollar exchange even for acquiring replacement capital goods. And public agitation on the subject only produced a promise to create a Dollar Fund comprising 'a part of the dollars accruing from India's export surplus to the U.S.A.,' the amount being 'earmarked specifically for India's post-war development'.[40] The Fund, of which the trustee is the Bank of England, has been started with a magnificent contribution of $ 20 million (Rs. 0.60 crores) during the calendar year 1944; we are told that a similar amount would be added in 1945.[41]

XVII. SUMMARY AND CONCLUSIONS

To summarize: The problem of the sterling assets is exceedingly intricate. Its settlement must be the subject of careful deliberation and negotiation. But it would seem probable that of the eight several alternatives reviewed above recourse would be had, to the full extent permissible, to (1) and (2), if circumstances require it, also to (3). Alternative (6), however, is likely to receive special favour and it is possible that major reliance would be placed upon it for the liquidation of the sterling debt. Pending the necessary deliberation in respect of the details regarding these probable alternatives, alternative (5), the status quo, would, of course, remain in force. As we have seen, so long as trade, exchange and shipping restrictions continued, it is possible so to work this alternative as to render it more or less identical with alternative (6).

40. *Budget for 1945-46*, p. 16.

41. Ibid; according to Dr. Harry White, the aggregate value today of the dollar credits, gold and dollar securities at the disposal of U.K. is $3,500 million. *The Eastern Economist*, p. 195.

It is possible, too, that exchange control will be maintained
n currently accruing exchanges as well. There exists also
very prospect of our continuing to subscribe to the dollar
ool and of the rupee being maintained at its statutory par.
hese possibilities are suggested by the provisions of the
Anglo-Egyptian financial agreement which were disclosed in
anuary 1945[42] and which have every chance of being treated
s a pattern for future agreements with other territories of
he dependent Empire. Under the agreement Egypt will
urrender 'to the United Kingdom, against payment in
terling, all foreign currencies obtained in its international
ransactions'; that is, she will be a subscriber to the Dollar
ool. Her foreign currency requirements will be met by the
Jnited Kingdom, sterling area currencies on demand, certain
on-sterling currencies described as 'easy' currencies[43]
without any strict limit'—and 'difficult' currencies, among
which are included U.S. dollars, Canadian dollars, Swiss
rancs, Swedish kronor and Portuguese escudos, in strictly
ationed amounts. The target figure for difficult currencies,
which, under certain circumstances, may be revised upwards,
as been fixed at £ E 15 million for 1945. Trade controls will
e retained in order to ensure that imports from easy currency
reas are limited to 'the real needs of Egypt' and to restrict
heir volume from hard currency areas to the available
uantities of exchange.

From the Indian standpoint, however, assuming that we
ad complete autonomy of monetary and economic policy, the
llowing course of action would seem to be most desirable:—

(i) Devalue the rupee to its correct parity and, preferably, delink it from sterling so that we may be able not only to pursue such monetary policy as Indian interests may demand but also to prevent the undesirable effects on India of the British monetary policy;

42. Cmd. 6582, quoted by *The Economist*, 20 January 1945, pp. 84-85.
43. E.g. currencies of liberated Europe.

(ii) secure, if possible, a guarantee from the British Government of the value of the sterling assets by a gold clause as a safeguard against the devaluation or the depreciation of sterling;

(iii) block the war-time accumulated sterling assets for all transactions, within as well as without the Empire;

(iv) release the blocked sterling assets in accordance with the absorptive capacity of the Indian economy to pay only for capital goods, essential materials and specialized labour;

(v) enter into an agreement with the United Kingdom for the acquisition of the requirements indicated in (iii) above, depending upon the sterling area for their supply to the extent possible, and making the necessary arrangements, with Great Britain, for the provision of the requisite amounts of foreign exchange, for the importation of the rest from the outside world;

(vi) retain the machinery of exchange and trade controls during the period of transition in order to prevent the foreigner from taking undue advantage, to the detriment of India, of the sellers' market, which must prevail for some time, and also to ensure that part of the currently accruing foreign exchanges was conserved for financing the economic development of the country;

(vii) keep out of the Empire Dollar Pool in order to prevent other people from sharing with us our dollar earnings.

Since the assumption we have made is, however, not likely to hold true, the policy, which rests upon it for its success, must remain of academic interest merely. This raises the question whether the more probable alternatives of policy are capable of being so amended as to satisfy the needs of this country within their very restricted framework. The following ideas suggest themselves:—

(i) If major reliance must be placed upon alternative (6) for the redemption of the sterling debt, prefer even rejuvenated or obsolete capital goods and other equipment to aspirin, mouth organs and such other consumer goods;

(ii) if redemption must be spread over a large number of years, get the floating debt funded so that the Indian economy might have the benefit of the long-term rate of interest in place of the nominal returns obtainable on cash balances and sterling treasury bills;

(iii) if the link with sterling must remain, secure devaluation of the rupee to its correct level;

(iv) if we have no option but to continue to subscribe to the Empire Dollar Pool, try to get from it as much as we contribute to it for the purchase of investment goods, so that at least our current output could be employed for the economic development of the country;

(v) raise, if possible, a dollar loan in America for financing Indian economic development, earmarking, if necessary, part or whole of the dollars accruing under (iv) above for service on the loan, so that implementation of the schemes of economic expansion may become possible on a larger scale than would be permissible under alternative (6);

(vi) resist as far as possible resort being taken to alternatives (1) and (2) and also to alternative (3).

It must not be supposed, however, that full success on all these six points, which in itself is far from probable, would take alternative (6) anywhere near to alternative (5). Since it is not possible both to eat a cake and make a gift of it, the two alternatives are, in fact, diametrically opposed to one another. We can have either the one or the other, not both. In comparison with the benefits of alternative (5), the concessions asked for are in the nature of but crumbs, though the suggested scheme for a dollar loan might be somewhat of an exception, if the dollars allotted to us from the Pool should

suffice to raise a loan of, say, $100 million a year for fifteen years. This would enable investment of an aggregate amount of $1,500 million (Rs. 455·25 crores) during the period.

But it is important to note that if this debt is held as a charge on, and is made extinguishable from, the current output of the country, we will not be drawing upon the sterling assets at all. It would be merely a case of the post-war output of the country being utilized, through the Dollar Pool, for Indian economic advancement. If, on the other hand, the debt is ultimately set against the sterling assets, it becomes a charge upon the current output of Great Britain, as the latter would have, then, to find the necessary funds for its liquidation on behalf of India. And, from the British standpoint, so far from this being regarded as an improvement upon the present position, it may be deemed to be a worsening of it, since a dollar debt owing to America would be very much on a different plane from a sterling debt owing to India. Some of the alternatives of payment open in the case of the one may not exist at all in the other and the ratio between the convenience of the debtor and the requirements of the creditor in the matter of debt redemption may be of a different order. In the circumstances it is exceedingly doubtful whether Great Britain may readily agree to such an arrangement.

INDEX

Printed by G. S. Press, Madras
P.I.C. MS. 97 for Indian Council of World Affairs, Delhi, 18—3—1946